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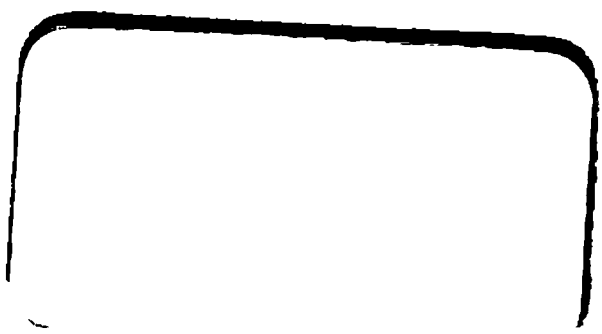
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A TREATISE
ON THE
MODERN LAW OF CORPORATIONS
WITH REFERENCE TO
FORMATION AND OPERATION
UNDER GENERAL LAWS

BY
ARTHUR W. MACHEN, JR.
OF THE BALTIMORE BAR

IN TWO VOLUMES
VOLUME I.

BOSTON
LITTLE, BROWN, AND COMPANY
1908

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*Onus si tantum opinione prima concipere potuissem quanto me premi ferens sentio, maturius consulissem vires meas. Sed initio, pudor omit-
tendi quae promiseram tenuit: mox, quamquam per singulas prope partes labor cresceret, ne perderem quae jam effecta erant, per omnes difficultates animo me sustentavi. Quare nunc quoque, licet major quam umquam moles premat, tamen prospicienti finem mihi constitutum est vel deficere potius quam desperare. — QUINTIL., De Inst. Orat., Lib. XII, prooem.*

PREFACE

In these volumes I have aimed to approach the law of our ordinary business corporations from a point of view more peculiarly appropriate to companies incorporated under general laws than has heretofore been customary. It seemed to me desirable to reject as obsolete much of the old law of corporations formed under royal charters in England, together with its terminology, and to treat the modern law upon a plan which should recognize incorporation under general laws, rather than incorporation under royal charters or under special acts of the legislature, as the normal method of incorporation. In the second place, I have aimed to treat fully and, so far as possible, exhaustively, those topics which the rapid development of the law of incorporated companies both in Great Britain and in the United States has but recently brought into practical importance, and also any other topics which for any other reason seemed to me to need fuller or further treatment than is accorded in the serviceable text-books with which American lawyers are familiar.

Among the topics which an attempt has been made to analyze with especial thoroughness may be mentioned the law of the preparation, construction, and filing of incorporation papers, the law of promoters, of underwriting agreements, the law of preferred shares, of increase and reduction of capital, of transfers of shares, of directors' and shareholders' meetings, of by-laws, and of dividends, and many subdivisions of the law of bonds and mortgages.

I have regarded the corporation as a living organism, and have not attempted to treat, except incidentally, those parts of the law which relate to its death, or winding-up and dissolution, or those parts of the law which existing American text-books have treated so fully and satisfactorily as to render any other treatment both presumptuous and unnecessary.

PREFACE

The branches or sub-divisions of corporation law which have been altogether excluded embrace (1) the entire topic of the relation of corporations to the state or to the public, including all questions as to the constitutional powers of the legislature under our American state and federal constitutions in dealing with corporations and their affairs, and also including the right of the state, or of the attorney-general as its representative, to interfere in corporate management by *quo warranto*, *scire facias*, injunction or otherwise, and also the criminal liabilities of corporations and their officers, and also the topic of taxation of corporations and corporate securities, (2) the topic of foreign corporations, which may fairly be considered a branch of the subject of conflict of laws, and (3) the topic of winding-up and dissolution and the related topics, including especially the various statutory liabilities of shareholders and directors to creditors, which remain dormant so long as the company is prosperous and awake into practical importance only when winding-up or liquidation is imminent, and also including consolidation and reorganization, both of which involve, at least in a qualified sense, a dissolution of the old corporation.

The only important exceptions to these rules of exclusion will be found in the chapters on bonds and mortgages, in connection with which it became necessary to deal with certain branches of the law of winding-up and of reorganization.

In dealing with topics which, although within the general scope of the work as outlined above, have yet for many years attracted attention from American courts, lawyers, and text-writers, I have tried to avoid useless threshing over of old straw, and therefore have not descended into detail except where I hoped to present some new or different aspect of the subject or some particular novel points. To take a concrete instance, a very large proportion of all the corporation cases which have been decided in this country have related to liability upon unpaid subscriptions to capital. These numerous cases have been carefully digested and explained in text-books with which every lawyer is acquainted. Consequently, I have tried to avoid mere repetition of matter which is already easily accessible to every reader; and instead, I have summarized the general currents of authority, pointing out or emphasizing certain new ways of looking at the subject, and elaborating fully some par-

PREFACE

ticular points which have been heretofore overlooked or slighted — such, for example, as the peculiarities of subscriptions to shares entered into by signing the incorporation paper or certificate, or articles, of incorporation.

After the citation of a case, the words “headnote inadequate” will not infrequently be found in parenthesis. These words do not indicate an opinion that the case is badly reported. On the contrary, no headnote can, consistently with that brevity which is indispensable, call attention to all the points or features of a case; and by using the words “headnote inadequate,” I design simply to guard the reader against rejecting a case as not in point merely because the headnote does not indicate that the decision involves the particular proposition for which the case is cited.

References are given to the National Reporter System, the Lawyers’ Reports Annotated, the American Reports, American State Reports and American Decisions, as well as to the official state reports. Wherever references are given to two or more reports of the same case, the report which follows immediately after the name of the case — usually, with the exception of very recent cases, the official report — is that which I have examined and used in the preparation of this book and to which alone, therefore, comments with respect to the headnote are applied.

A. W. M., JR.

BALTIMORE, June 17th, 1908.

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ADDENDA

CASES OF ESPECIAL INTEREST REPORTED WHILE THIS BOOK WAS GOING THROUGH THE PRESS.

National Life Ins. Co. of the United States v. National Life Ins. Co., 209 U. S. 317, modifying or supplementing the law as stated in § 456, holds that where a corporation has engaged in business under a certain name at a certain city before the incorporation of another company under substantially the same name, the courts will not supervise the discretion of the post office authorities, so as to enjoin them from delivering to the former company mail matter addressed to the common name at the city in question, without any distinguishing street or number, merely because a vastly larger proportion of such matter may have been found by experience to be intended for the second company.

Richardson v. Shaw, 209 U. S. 365, and *Thomas v. Taggart*, 209 U. S. 385, are important cases, although laying down no novel propositions of law, upon the subject of purchases of shares on margin and of the mutual rights of pledgors and pledgees of shares.

MODERN CORPORATION LAW

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§ 1. **Formation of Corporations at Common Law.** — By the common law of England, corporations could be formed in only one way — by a special charter granted by the crown. To be sure, the legislature by special act might create a corporation; but an act of the legislature involves a change in the law, so that a corporation formed by special act of the legislature could not properly be said to be organized under the common law. No sufficient sound economic reason applicable to modern conditions can be adduced to support this common law doctrine. For, in a free commercial country, individuals should have the power by mere private contract or agreement to associate themselves together as a corporation for any merely private lawful object. They should enjoy the same freedom in the formation of corporations that Anglo-Saxon jurisprudence has always accorded in the formation of partnerships or voluntary associations. To be sure, safeguards should be provided against fraud, and particularly against abuse of that immunity from individual liability of the members for the debts of the company which in popular estimation constitutes the most valuable, if not the most essential, characteristic of a commercial corporation. But subject to all needful restrictions of this sort, the organization of corporations in any country that prides itself on freedom of contract and on the right of its citizens to cooperate in the most effective manner in any lawful enterprise, should be as free as the formation of unincorporated associations; and most certainly the benefits of doing business under the corporate form should not be dependent on the caprice of a monarch or of a minister, or upon the special favor of the legislature.

§ 2. **Common Law Rule in America.** — Nevertheless, the common law prohibition of corporations except by royal charter was carried by our ancestors across the Atlantic, and became part of the jurisprudence of the United States. In colonial times, the king did occasionally erect corporations in America

by his charter, as witness the well-known instance of Dartmouth College.¹ In some of the colonies, notably in Maryland² and Pennsylvania,³ this prerogative of the crown was delegated in part or in whole to the lord proprietary or viceroy, and by him sparingly exercised; but if in any colony the prerogative extended to the incorporation of business corporations, no instance is known in which it was exercised for that purpose.

After the Declaration of Independence, the prerogative perished altogether; and was not renewed or vested by the various state constitutions in the executive. Accordingly, the royal charter, the only common law method of forming corporations, having become impracticable, persons desiring to become incorporated were obliged in each case to apply to the legislature for a special act of incorporation. Thus, the separation from the mother country, the abolition of the royal prerogative, and the endeavor to preserve and even to increase the individual liberties previously enjoyed by the colonists as British subjects, resulted, curiously enough, in depriving the American people of the only mode of incorporating known to the common law, and thus in still further restricting the already too limited power of organizing corporations.

§ 3. Dissimilarity of American Statutory Corporations and Corporations formed by Royal Charter.—In the United States, although royal charters of incorporation have been obsolete for

¹ See *Dartmouth College v. Woodward*, 4 Wheat. 518.

² See Charter of Maryland, § 14 (Kilty's Laws of Md.; Md. Code Pub. Gen. Laws of 1904, p. 100), where the Lord Proprietary was invested with the power "Villas item in Burgos et Burgos in Civitates ad Inhabitantium Merita et Locorum Opportunitates cum Privilegiis et Immunitatibus congruis erigendi et incorporandi." Perhaps the only exercise of this power was the grant of a charter by Lord Baltimore in 1667, incorporating the "Mayor, Recorder, Aldermen, and Common Council of the City of St. Mary's City." See *McKim v. Odom*, 3 Bland Ch. (Md.), 407, 416, note, where a recital of some of the terms of the charter will be found. The

city of Annapolis was incorporated by a deputy of Queen Anne during the suspension of the proprietary government, and the charter was confirmed with modifications by Act of Assembly, Laws of Md. of 1708, Chap. 7.

³ Charter of Pennsylvania, § 10 (Charters and Provincial Laws of Pa., ed. of 1762, p. 3), where Charles II granted to Penn and his heirs power "to erect and incorporate towns into boroughs and boroughs into cities." In pursuance of this power, the proprietary granted a charter of incorporation in 1701 to the city of Philadelphia, and subsequently erected a number of boroughs. Charters and Provincial Laws of Pa., ed. of 1762, pp. 10 et seq. See also 3 Wilson's Lectures, 409.

more than a century, the old terminology has to a great extent survived, and is applied to the wholly different statutory corporations of to-day. Thus, special acts of incorporation are, in America, commonly called "charters," although this use of the term is perhaps inappropriate and is certainly not in vogue in England. There, "charter" still means a royal charter, and is very rarely applied to a special act of parliament creating a corporation.¹ Indeed, the American law of corporations is not merely in terminology but to some extent in substance an outgrowth of the old law of corporations formed under royal charter. This is certainly unfortunate; for what law there is relating to the old corporations chartered by the crown — and the cases on the subject are comparatively few and meagre — is of an antiquated nature, totally inapplicable to modern joint-stock business corporations. The greatest harm that has come from assimilating modern incorporated companies to old-fashioned chartered corporations is the notion that the right to be a corporation is a special franchise. To be sure, this was true at common law; but as stated above this feature of the common law was an anomaly in the jurisprudence of a free country, and, as will be more fully explained below,² it is now completely abrogated both in England and in most of the United States, where the right to incorporate for any lawful object is free to everybody, on observing certain statutory formalities.

§ 4-§ 13. DEVELOPMENT OF CORPORATION OR COMPANY LAW IN ENGLAND

§ 4. **Incorporation by Royal Charter.** — Even in England the formation of corporations by royal charter, although always possible, was never frequent, and is perhaps at the present day even rarer than ever. The corporations organized in this way have been chiefly for municipal, charitable, educational, or religious purposes, and have but little in common with the ordi-

¹ In *Simpson v. Molson's Bank* (1895), A. C. 270, the reporter in his statement of the facts of the case refers to a special act of incorporation as a "charter," and in *Attorney-General v. Mersey Ry. Co.* (1907), A. C. 415, 417, Lord Macnaghten uses the word in that sense. For an instance of similar use of the word in Canada, see *McMurrich v. Bond Head Harbour Co.*, 9 Up. Can. Q. B. 333, 336.

² See *infra*, § 19-§ 20.

nary business corporation of to-day. Some famous historic organizations, formed partly for private gain and partly for public governmental objects, such as the East India Company, were incorporated in this way. The Bank of England was incorporated by royal charter but in pursuance of a special act of parliament.¹

§ 5. **Incorporation by Special Act of Parliament — The “Companies Clauses Consolidation Act.”** — In England, partly because the crown was for some reason so very chary in granting charters of incorporation, applications to parliament for special acts of incorporation became more and more frequent as business conditions developed and the desirability of incorporating became constantly greater.² Special acts of incorporation particularly for canal and railway companies accordingly multiplied apace. A general resemblance pervaded all of these special acts; but each was characterized by its own peculiar features. As the general scheme or constitution of all such corporations was the same or nearly so, the same language to a great extent was employed in all such special acts; and, in order to avoid this repetition, parliament in 1845 adopted a code or system of provisions which should be taken as embodied in all subsequent special acts of incorporation,³ except in so far as expressly excluded. This code is known as the “Companies Clauses Consolidation Act,” sometimes abbreviated to “Companies Clauses Act.” At the same session of parliament, a statute was passed, known as the “Railway Clauses Consolidation Act,” containing certain provisions as to the construction of railways which in like manner were to be taken as embodied in all subsequent special acts for the incorporation of railway companies.⁴ These statutes, it will be

¹ Stat. 5 & 6 W. & M., c. 20. See 1 Black. Comm. 473.

² As Blackstone points out, special acts of parliament creating corporations had become common only in his own time. 1 Black. Comm. 473.

³ 8 & 9 Vict., c. 16. See also “Companies Clauses Consolidation Act (Scotland),” 8 & 9 Vict., c. 17, a similar act applicable to Scotland. Later “Companies Clauses Acts”

are the “Companies Clauses Act, 1863,” the “Companies Clauses Act, 1869,” the “Companies Clauses Consolidation Act, 1888,” and the “Companies Clauses Consolidation Act, 1889.”

⁴ 8 & 9 Vict., c. 20. See the “Lands Clauses Consolidation Act,” 8 & 9 Vict., c. 18, containing provisions to apply to companies upon which the power of condemning land should be conferred.

observed, are not general incorporation laws, and do not apply to companies organized under general laws or "Companies Acts," the first of which had been passed in the preceding year.

This separation between matters so distinct as a general enabling act and the establishment of regulations for companies thereafter incorporated by special act certainly avoids confusion; and the example might perhaps profitably be followed in those American states where special acts of incorporation are still resorted to. Much trouble has been occasioned by endeavoring to combine in one act or code general provisions for the formation of corporations and for the regulation of the companies formed thereunder, with provisions for the regulation of such companies as the legislature had previously incorporated or might subsequently see fit to incorporate by special act, the only object of which latter provisions is avoidance of the necessity of inserting in each special act a complete system of corporation law.¹ This trouble and confusion might be obviated, it would seem, by the passage of a "Companies Clauses Act"; although this opinion must be expressed with diffidence, inasmuch as some English lawyers advocate, as tending to greater simplicity, a consolidation of the Companies Clauses Acts with the Companies Acts.²

¹ Cf. *Gregg v. Granby Mining, etc. Co.* (Mo.), 65 S. W. 312 (a constitutional provision making all charters of incorporation subject to amendment or repeal by the legislature held to apply both to companies incorporated under general laws and companies created by special act); *Montclair v. N. Y. & Greenwood Lake Ry. Co.*, 45 N. J. Eq. 436, 441-442; 18 Atl. 242; *Hayes v. Morgan's La., etc. Co.*, 42 So. 150; 117 La. 593; *Frazier v. Railway Co.*, 88 Tenn. 138 (headnote 8); 12 S. W. 537; *City of Atlanta v. Gate City Gas Light Co.*, 71 Ga. 106 (provision in general incorporation law that "no charter shall have any force or effect for a longer period than two years unless the incorporators within that time shall in good faith commence to exercise the powers

granted by the act of incorporation," held not to apply to corporations created by special act of the legislature but only to those formed under the general law); *Love v. Holmes* (Miss.), 44 So. 835 (municipal corporation created by special act, held not subject to a limitation of municipal indebtedness prescribed by the general statutes applicable to municipalities); *State v. Cape Girardeau, etc. Road Co.* (Mo.), 105 S. W. 761 (where the question was decided whether a turnpike company incorporated by special act was subject to a provision in a statute applicable to corporations generally, or to a different provision in a general law for incorporation of turnpike companies).

² Rawlins & Macnaghten on Companies, preface, pp. v-vi.

§ 6. **Development of Unincorporated Joint-stock Companies.** — **The Bubble Act.** — Side by side with the constantly increasing frequency of incorporation by special statutes, which occasioned the Companies Clauses Consolidation Act, there developed in England out of the ordinary partnership a form of association known as joint-stock companies, which, although unincorporated, much more closely resemble the ordinary stock corporations of to-day than do the common law corporations chartered by the crown. These joint-stock companies originated in an attempt to secure so far as practicable by mere mutual agreement among the members the same advantages that would be obtained by incorporation. Parliament unwisely frowned upon this endeavor, and the Bubble Act¹ sought altogether to repress it. That statute, however, never proved very effective in accomplishing its purpose,² and in 1825 was repealed.³ Notwithstanding this repeal, some judges continued to look askance at these associations;⁴ but other judges evinced a more liberal disposition,⁵ and the number of such companies constantly increased.

Although these unincorporated joint-stock companies were, in legal contemplation, nothing but huge partnerships distinguished from ordinary firms only by the number of their members, yet the ingenuity of the cleverest solicitors was taxed in order to give them, practically, all the most important attributes of corporations. Every member or shareholder was required to sign and seal the company's deed of settlement, which contained elaborate provisions for the government of the concern. Particularly, it provided that the partnership should not be dissolved by the death of a member but that his personal representative should on executing the deed of settlement become a member in his room. Transfers of shares *inter vivos* were also provided for. Moreover, the management of the company was vested in a board of directors, and the deed always stipulated that a mere private member or partner should have no power to act as agent for the concern. The

¹ 6 Geo. I, c. 18, § 18.

⁵ *Harrison v. Heathorn*, 6 Man. &

² Cf. *Rex v. Webb*, 14 East 406; Gr. 81; *Re Aston*, 27 Beav. 474, *Rex v. Dodd*, 9 East 516; *Josephs v. Prebber*, 3 B. & C. 639.

affirmed, 4 De G. & J. 320; *Mexican, etc. Co.*, 4 De G. & J. 544. Cf. cases cited, *infra*, § 17.

³ 6 Geo. IV, c. 91.

⁴ *Blundell v. Winsor*, 8 Sim. 601.

capital of the company was to consist of a certain amount divided into shares, very much as in the modern stock corporation. Sometimes it was sought to approximate limited liability by providing that all the company's contracts should contain a clause by which the contractor should agree to look only to the capital of the company for his damages in case of breach.¹ How to avoid the necessity of making all of the shareholders parties to any action or suit by the company was a serious problem. Sometimes special acts of parliament were obtained authorizing the association to sue and be sued in the name of some officer, and in 1835 a general statute authorized the crown to grant to unincorporated companies the right to sue and defend in the name of an officer.² Sometimes the legal title to the company's property and *choses in action* was vested in trustees, who would thus be entitled to sue in their own names for any breach of contract or injury to the company's property.³ Of course, the members of such companies were not greatly concerned in facilitating actions *against* the companies; and, moreover, failure to join all the members as defendants in actions of tort was no irregularity at all, and even in actions of contract could not be availed of except by plea in abatement.⁴

§ 7-§ 13. *General Incorporation Laws.*

§ 7. **The Statute of 39 Elizabeth Chapter 5.** — As long ago as the reign of Elizabeth a general statute for the incorporation of hospitals and similar charities had been enacted by parliament.⁵ This act provided that any person seised of land in fee simple might by deed enrolled in the High Court of Chancery create a corporation to hold the land for the purpose of a "hospital, *maison de dieu*, abiding place or house of correction."⁶ By its

¹ E. g. *Ex parte Liquidators of British Nation Life Ass. Ass'n*, 8 Ch. D. 679.

² 4 & 5 Wm. IV, c. 94.

³ Cf. *Weir v. Metropolitan Street Ry. Co.* (Mo.), 103 S. W. 583 (where a similar device was held not to obviate the necessity for making all the shareholders parties). It would seem that the case last cited misapplies *Niven v. Spickerman*, 12 Johns. (N. Y.) 401, where it was

held that an unincorporated company could not sue in the names of its "trustees," who, however, do not appear to have been invested with legal title, but seem to have been mere directors.

⁴ Cf. *McCreary v. Chandler*, 58 Me. 537.

⁵ 39 Eliz., c. 5.

⁶ See 2 Coke Inst., 720-725, where the statute is commented upon and a form of a deed is given.

terms the act was to continue in force for only twenty years; but a few years after its expiration it was revived and made perpetual.¹ Notwithstanding the interest attaching to this statute as the first general incorporation act in a common-law jurisdiction, its effect upon the history of English law has been negligible. Modern English general incorporation laws were not suggested by this statute of Elizabeth but were evolved from the statutes mentioned in the last paragraph, which removed impediments in the way of the formation and operation of joint-stock companies.

§ 8. **Companies Act of 1844.** — In 1844, Parliament, which by the above mentioned Acts of 1825 and 1835 had already abandoned the policy of discouraging combinations of men and money for legitimate business purposes, definitively embarked upon the enlightened course of facilitating rather than thwarting all such enterprises. In that year, the first English general incorporation law, or companies act, was passed — the “Joint Stock Companies Registration Act,” or Companies Act of 1844.² This statute, after providing as to companies to be organized under it for a preliminary embryonic period of “provisional registration,”³ went on to enact that the subscribers to the capital of the projected company should sign and seal a “deed of settlement” stating among other things the business or purpose of the company, the amount of its capital and the number of shares into which it should be divided, the amount authorized to be raised by loan, etc. The deed was also to contain a covenant by each shareholder to pay all instalments of his subscription to the capital and perform all engagements resting upon him as shareholder. Upon the due execution of this deed, it was to be recorded, after which a “certificate of complete registration” might be obtained. Thenceforth, the company was incorporated for the purpose of carrying on the trade or business for which it was formed, but without restriction of liability of the shareholders under any judgment or decree. With this important exception, the act conferred all advantages of doing business under a corporate form. Finally, by an amendatory statute passed some ten years later,⁴ the privilege of limited liability was conferred upon members of all companies organ-

¹ Stat. 21 Jac. 1, c. 1.

² 7 & 8 Vict., c. 110.

³ See *infra*, § 312.

⁴ 18 & 19 Vict., c. 133.

ized under the Act of 1844 whose deed of settlement should provide therefor and whose name should contain the word "Limited."

§ 9. **Companies Act of 1856.** — In the year following, that is to say, in 1856, the Act of 1844 with its amendments was repealed, and a new and more progressive system was adopted known as the Companies Act of 1856.¹ This statute provided for the formation of corporations with either limited or unlimited liability. It was in its main features similar to the Companies Act of 1862² by which six years later it was superseded and which, being still the basis of the company law of England and having given rise to many leading cases, demands somewhat detailed examination.

§ 10. **Companies Act of 1862.** — *The Memorandum of Association.* — Under the Companies Act of 1862,³ the method of forming corporations and the general nature of their constitution is as follows: First, at least seven persons sign a document known as the "memorandum of association," which must state where the company is formed on the principle of having the liability of its members limited to the amount, if any, unpaid on their shares, the company's name, the location of its office, its objects, the fact that the liability of its members is limited, and the amount of its capital divided into shares of a certain fixed amount. Each subscriber to the document shall write opposite his name the number of shares he takes, and must take at least one. This memorandum of association is then lodged for record with the registrar of joint-stock companies, who after its registration issues a certificate stating that the company is incorporated; and thenceforth the company is a corporation.

The memorandum of association, it will be observed, embodies the fundamental constitution of an English company. It must state the company's objects, and any object not therein contained is *ultra vires* of the corporation.⁴ It corresponds to the instrument that in some American states is

¹ 19 & 20 Vict., c. 47.

² 25 & 26 Vict., c. 89.

³ 25 & 26 Vict., c. 89.

⁴ "The memorandum of association, is, as it were, the area beyond which the action of the company cannot go; inside that area the

shareholders may make such regulations for their own government as they think fit." Per Lord Cairns in *Ashbury Ry. Carriage Co. v. Riche*, L. R. 7 H. L. 653. 671 See also *infra*, p. 11 note 2.

called a "certificate of incorporation," and in others "articles of association."¹

§ 11. *The Articles of Association.* — Contemporaneously with the filing of the memorandum of association, the incorporators under the Companies Act of 1862 may file for record what are known as "articles of association," containing regulations for the management of the company and the conduct of its business. These partake of the nature of by-laws according to American terminology; but, inasmuch as they are recorded, all who deal with the company are chargeable with notice of their contents. They must be carefully distinguished from the memorandum of association, to which they are distinctly subordinate.² As a learned judge has said, "the memorandum of association is the constitution of the company," while the articles are "merely the machinery for carrying that into effect."³ And, of course, the English articles must not be confused with what in some American states are known by the same name, — articles of association, — which as stated in the last paragraph

¹ See *infra*, § 31.

² In *Ashbury Ry. Carriage Co. v. Riche*, L. R. 7 H. L. 653, 667-668, Lord Cairns said: "I will ask your Lordships to observe *** the marked and entire difference there is between the two documents which form the title deeds of companies of this description — I mean the Memorandum of Association on the one hand and the Articles of Association on the other hand. With regard to the memorandum of association, your Lordships will find, as has often been pointed out, although it appears to have been somewhat overlooked in the present case, that that is, as it were, the charter, and defines the limitation of the powers of a company to be established under the act. With regard to the articles of association, those articles play a part subsidiary to the memorandum of association. They accept the memorandum of association as the charter of the company, and so accepting it, the articles proceed to define the duties,

the rights and the powers of the governing body as between themselves and the company at large, and the mode and form in which the business of the company is to be carried on, and the mode and form in which changes in the internal regulations of the company may from time to time be made. With regard, therefore, to the memorandum of association, if you find anything which goes beyond that memorandum, or is not warranted by it, the question will arise whether that which is so done is *ultra vires*, not only of the directors of the company, but of the company itself. With regard to the articles of association, if you find anything which, still keeping within the memorandum of association, is a violation of the articles of association, or in excess of them, the question will arise whether that is anything more than an act *extra vires* the directors, but *intra vires* the company."

³ *Tilbury Portland Cement Co.*, 62 L. J. Ch. 814, 815.

correspond to the *memorandum* of association of an English company. The articles cannot add to or subtract from the memorandum. For instance, a power that is not conferred upon the company by the memorandum is *ultra vires* even though expressly authorized by the articles.¹

But so great latitude is allowed by the statute, and so few particulars as to the company's constitution are required to be stated in the memorandum, that many matters of deep concern to the company are left to be regulated by the articles. For example, the articles may regulate the number and powers of directors, their term of office, the manner of their appointment or election, the method of conducting general meetings of the company, the number of votes to which each shareholder shall be entitled, the manner of transferring shares, calls for unpaid subscriptions to capital, the forfeiture of shares, and many other matters of equal or greater importance. Parliament has undertaken to prescribe no hard and fast rules on such subjects of internal management, but has wisely left each corporation to regulate them for itself according to its own conceptions of its needs. The result is a freedom of regulation which is probably obtainable nowhere in the United States. In the not distant future, however, some state legislature may perceive that these matters, at least in the case of industrial corporations, are of purely private concern and should accordingly be committed entirely to the parties interested. The prediction may be ventured that when one state shall have taken the lead in this direction, others will fast follow the example.

§ 12. "*Table A.*" — As already stated, the promoters of an English company may prepare for their corporation such articles of association as they please, so long as no rule of law or of public policy is contravened. But the act provides, in a schedule annexed thereto known as "*Table A.*" a very complete set of articles, which are to apply to any company "limited by shares" unless other articles be adopted. Accordingly, any such company may be registered without articles, and in that event *Table A* will constitute its articles. Moreover, even where *Table A* is not thus adopted *in toto*, it serves as a convenient model for such articles as may be desired; and often the articles adopt or embody some of the provisions of *Table A*, but modify

¹ *Ashbury Ry. Carriage Co. v. Riche*, L. R. 7 H. L. 653, 671.

or exclude the remainder. An English writer questions the desirability of providing by statute any such form or model of articles of association.¹ But all who have experienced the difficulties that are occasioned in America by the frequent failure of corporations to adopt any by-laws will readily perceive the advantages to be derived from a complete statutory code of internal regulations which is to govern every company except in so far as other regulations may be adopted by the company itself.

§ 13. **Amendments and Supplements to Companies Act of 1862 — Companies Act of 1900.** — The Companies Act of 1862 is still in force in Great Britain, and its main features remain unaltered. A number of amendatory or supplemental acts, however, have been passed.² Of these, the only one that makes any very substantial inroads on the general scheme for the formation and constitution of British corporations is the Companies Act of 1900. This statute, which has been criticised by some English lawyers as a bungling piece of legislation, provides, *inter alia*, that although a company becomes incorporated upon the issuance by the registrar of a certificate of due registration, yet no allotment of shares shall be made until a certain amount of capital shall have been subscribed, payable in cash, and that the company shall not commence business until a certain amount of capital has been allotted and other conditions complied with. Any contract made by a company before it is entitled to commence business shall be provisional only, and shall not be binding on the company until that date, when it shall become binding. It will be seen that these provisions, although making serious changes in the law governing the organization of corporations, leave untouched the fundamental scheme for incorporation by registration of a memorandum and articles.

¹ Palmer's Company Precedents, 9th ed., Appendix on "Revised Table A," p. 5.

² See "Companies Seals Act, 1864," 27 Vict., c. 19; "Companies Act, 1867," 30 & 31 Vict., c. 131; "Joint Stock Companies Arrangement Act, 1870," 33 & 34 Vict., c. 104; "Companies Act, 1877," 40 & 41 Vict., c. 26; "Companies Act, 1879," 42 & 43 Vict., c. 76; "Com-

panies Act, 1880," 43 Vict., c. 10; "Companies (Colonial Registers) Act, 1883," 46 & 47 Vict., c. 30; "Companies Act, 1886," 49 Vict., c. 23; "Companies (Winding-up) Act, 1890," 53 & 54 Vict., c. 63; "Companies Act, 1898," 61 & 62 Vict., c. 26; "Bodies Corporate (Joint Tenancy) Act," 62 & 63 Vict., c. 20; "Companies Act, 1900," 63 & 64 Vict., c. 48.

Within the last year, another statute, the Companies Act of 1907,¹ has made important changes in British company law, some of which will be noted from time to time below; but this act like its predecessors is a mere amendment or supplement to the Act of 1862 and not a substitute for it. Some of its provisions, as well as some of those of the Companies Act of 1900, display a tendency to multiply arbitrary statutory restrictions and thus to break in upon the freedom of internal company management allowed by the Act of 1862. Other provisions, however, are intended to remove, subject to certain conditions, hampering restrictions which had been imposed by judicial decision.

§ 14—§ 18. *Development of Modern Corporation
Law in the United States:*

§ 14. **In general.**—In America, corporation or company law has developed along somewhat the same lines as in England. In both countries, the same economic forces have been at work, and very similar results have been reached. Indeed, the development has been along converging rather than parallel lines; for the resemblance between American corporation law and English company law is closer at the present time than fifty years ago. The methods of incorporating in colonial times have been indicated briefly above. Before the Declaration of Independence, incorporation for business purposes had not even made a beginning. After the Revolution, the development has in each state pursued a course peculiar in many respects to the local jurisprudence, so that the history of this branch of the law throughout the nation cannot be traced except by the tedious and for present purposes profitless labor of investigating the course of legislation in each state. And to-day the law has attained very different stages of development in different states.

§ 15. **Growth of System of General Incorporation Laws.**—Everywhere, however, during the first half of the nineteenth century, incorporation by special act became increasingly frequent; and everywhere the necessity was felt of relieving the legislatures from the pressure of this business as well as of free-

¹ 7 Edw. VII, c. 50.

ing them from the temptation to corruption which such business was too apt to bring. As in England, general incorporation laws were the means adopted for attaining this result. The earliest general incorporation laws or enabling acts provided for the formation of religious corporations,¹ the need for which was experienced as soon as the Revolution had brought about disestablishment. The earliest general law for the formation of business corporations was passed in New York in 1811, providing for the incorporation of manufacturing companies.² As this law antedates the Companies Act of 1844 by more than thirty years, general incorporation laws may fairly be claimed as an American invention. To be sure, the statute of Elizabeth for the incorporation of hospitals preceded the New York statute by more than two centuries; but there is every reason to suppose that the New York statute was an original invention and was not even suggested by the long-forgotten statute of Elizabeth.

By the middle of the century, general enabling acts for the formation of manufacturing and mining corporations had become common throughout the United States. Gradually, the purposes for which companies could be incorporated under these general laws were extended, until at the present time, in all except a few ultra-conservative states, corporations may

¹ See Laws of N. Y. of 1784 (7th session), Chap. 18; Laws of Del. of 1787, Chap. cXLIV b (Laws of Del., ed. of 1797, Vol. II, p. 878); Laws of Pa. of 1791, Chap. MDXXVI (providing for incorporation for literary or charitable as well as for religious purposes); Laws of Md. of 1802, Chap. 111. Cf. Laws of Md. of 1798, Chap. 24, providing for the incorporation of vestries of the Protestant Episcopal Church which had been disestablished in 1776. Although the last mentioned statute has been held not to be a "public general law," *Bartlett v. Hipkins*, 76 Md. 5, 25-26, 34-37 (headnote inadequate); 23 Atl. 1089; 24 Atl. 532, yet it did certainly provide for the formation of an indefinite number of corporations.

² Laws of N. Y., Sess. 34, Chap. 67. For other early general incor-

poration laws, see Laws of Pa., Sess. of 1835-36, Chap. 194; Laws of N. Car. 1836 (2 Rev. Stats. of 1837, p. 214); 2 Kent Comm. 272, note (b), referring to a law of Massachusetts, and to laws of Connecticut and Michigan of 1837, as well as to the New York law above cited.

A statute of North Carolina, Laws of 1795, Chap. iii (Revised Laws, ed. of 1821, Vol. I, p. 769), sometimes referred to as a general incorporation law, provided that whenever a number of subscribers should have formed themselves into a company for the purpose of cutting a canal they should have the power to condemn private property and to sue and be sued in the company name, but does not expressly, nor it would seem by implication, make the companies corporations.

be organized under general laws for the conduct of any lawful business, with usually some few named exceptions. Even where the objects for which incorporation can be had are not expressed in these sweeping terms, they are so numerous and varied as to include all the usual forms of business enterprise.

§ 16. **Constitutional Prohibition of Incorporation by Special Act.** — Not merely have the legislatures voluntarily evolved this system of incorporation under general laws, but also the framers of state constitutions have undertaken to accelerate the process. In almost every recent state constitution some prohibition, more or less stringent, is directed against incorporation by special act. Consequently, incorporation under general laws has everywhere become the rule, and incorporation under special act the exception. Although much of the law governing corporations formed by special act is also applicable to those organized under general laws, yet the two kinds of associations are in many respects very different from one another; and these differences are or should be attended with important legal consequences.

§ 17. **Unincorporated Joint-stock Companies in America.** — Unincorporated joint-stock companies have played a much less important part in the development of incorporated companies in America than in England. Nevertheless, in some states such unincorporated associations have been at times very common,¹ and are probably everywhere in the United States legally possible.² These unincorporated bodies are, however, in America a by-product. The general trend of American law has not been influenced by such unincorporated joint-stock companies as have existed in this country. The only influence of unincorporated joint-stock companies upon American law has been indirect through the connection between English unincorporated companies and the modern English company law.

§ 18. **Modern General Incorporation Laws.** — Obviously, even cursory summaries of the general laws now in force in all the various states of the Union would be both tedious and, for

¹ For illustrations, see *Von Street Ry.* (Mo.), 103 S. W. 583 (as *Schmidt v. Huntington*, 1 Cal. 55; to *Adams Express Company*).
Hoadley v. County Comm'rs, 105 ² See *Spotswood v. Morris* (Idaho),
Mass. 519; *Weir v. Metropolitan* 85 Pac. 1094.

present purposes, useless.¹ The statutes in some states consist of a jumble of old acts thrown together almost indiscriminately with more recent amendments. In other states, the legislatures have intended to display the utmost liberality; but unfortunately this disposition has often been evinced by removing salutary restrictions and at the same time, in order to make a show of legislative regulation, by imposing vexatious and unreasoning restraints. The New Jersey Law has proved one of the most popular of the general incorporation laws, and has served as a model in many other states. It is not, however, altogether free from the faults above referred to.

In general, it may be said that the liberal incorporation laws that are in force in most states authorize incorporation for any lawful purpose by the mere execution and registration of a document setting forth the objects of the company and certain other particulars as to its proposed business and constitution.

§ 19-§ 22. *Effects of Modern Liberal Incorporation Laws.*

§ 19. **Right to Incorporate no longer a Franchise or Special Privilege.** — When individuals may incorporate themselves by these simple means, the notion that the right to be a corporation is a franchise is manifestly baseless. The right was formerly a franchise, when it could be secured only by the special favor of the crown or of the legislature. But a franchise is a special privilege, and any right that can be obtained by anybody merely by going through a few statutory forms cannot properly be designated by that term. As well might it be said that the right to make a conveyance of real estate is a franchise because the deed must be signed and sealed by the grantor with certain formalities and recorded in the registry of deeds. The requirements for the formation of a corporation are scarcely less simple. More than twenty years ago, Mr. Morawetz with his accustomed accuracy and insight said, "The right of forming a corporation and of acting in a corporate capacity, under the general incorporation laws, can be called a 'franchise' only in the sense in which the right of forming a limited partnership or of execut-

¹ The various statutes will be found analyzed in Frost on Incorporation and Organization of Corporations.

ing a conveyance of land by deed can be called a franchise.”¹ The progress of events and the development of jurisprudence in recent years make this statement more profoundly true and more important to be borne in mind than when it was uttered. To be sure, many corporations do hold franchises. For instance, the right to condemn private property or the right to operate a railway along the public streets or highways is a franchise, and these rights are frequently enjoyed by corporations. But the mere right to be a corporation for some purely private purpose is no longer of this character. We may call it a franchise if we choose, and we sometimes speak of taxes on the business of corporations as franchise-taxes; but in all such cases we are using the term with a new meaning. Always should the fact be recognized that nowadays when the right to organize a corporation is almost as free as the right to execute a deed of real estate, corporations are very different things from what they were when that right was confined to a few favorites of king or parliament.

§ 20. **Early Judicial Recognition of this Principle.** — These principles respecting the nature of the right to be a corporation under modern incorporation acts were recognized and stated in an early New York case where the court was dealing with, perhaps, the very first general incorporation law ever enacted for the formation of business corporations. The court, speaking by Chief Justice Spencer, said: “The object and intention of the legislature in authorizing the association of individuals for manufacturing purposes, was, in effect, to facilitate the formation of partnerships, without the risk ordinarily attending them, and to encourage internal manufactures. There is nothing of an exclusive nature in the statute; but the benefits from associating and becoming incorporated, for the purposes held out in the act, are offered to all who will conform to its requisitions. *There are no franchises or privileges* which are not common to the whole community. In this respect, incorporations under the statute differ from corporations to whom some exclusive or peculiar privileges are granted.”²

¹ 2 Morawetz on Priv. Corps., 2d ed., § 923. Approved: *State ex rel. Bradford v. Western Irrigating Co.*, 40 Kans. 96, 99 (head-note inadequate); 19 Pac. 349; 10 Am. St. Rep. 166. ² *Slee v. Broom*, 19 Johns. (N. Y.) 456, 473–474; 10 Am. Dec. 273, referring to the N. Y. Act of 1811, cited above, § 15.

§ 21. **Liberal Construction of Modern Incorporation Laws.** — In construing modern general incorporation laws, these principles should always be borne in mind. We should never forget that the object of such laws is to further the prosperity of the country by promoting commercial enterprise, and that this object should not be thwarted by a narrow construction different in spirit from that in which the laws themselves are conceived. Fraud should be effectively punished; but in order to prevent frauds, the courts should not discourage enterprise. It is easy to prevent fraud by stopping commercial intercourse; but the remedy, if not worse, is more disastrous than the disease. An attempt to prevent the growth of fraudulent schemes and unlawful "trusts" by a strict construction of the general incorporation laws may perhaps hinder, somewhat, monopolistic schemes, but it will certainly absolutely prohibit many legitimate business enterprises.

§ 22. **Frauds perpetrated under cover of Liberal Incorporation Laws.** — Moreover, the fact that frauds are committed by abuse of the incorporation laws should not be allowed to obscure the fact that such frauds are small in comparison with the amount of good that is accomplished by liberal laws liberally construed. As was said by a learned English judge in a recent case, "The statutes relating to limited liability have probably done more than any legislation of the last fifty years to further the commercial prosperity of the country. They have, to the advantage as well of the investor as of the public, allowed and encouraged the aggregation of small or comparatively small sums into large capitals which have been employed in undertakings of great public utility, largely increasing the wealth of the country. But at the same time in this branch of the law the apathy of the public in setting the law in motion has, I will not say encouraged, but has at least failed to repress, grievous frauds which have been committed and too often have gone unpunished. Relatively, I think, compared with the advantages which have accrued from the law of limited liability, the mischief of such frauds has been small, but when regarded not relatively, but absolutely, the frauds which have been committed under cover of these acts have no doubt been great."¹

¹ *London & Globe Finance Corp.* (1903), 1 Ch. 728, 731-732, per Buckley, J.

§ 23-§ 29. CLASSIFICATION OF CORPORATIONS.

§ 23. **Distinction between Corporations formed under General Laws and Corporations created by Special Act.** — The most obvious classification of ordinary business corporations merely distinguishes corporations incorporated by special act from corporations organized under general laws. The gulf between these two classes of corporations is so great that little difficulty can be experienced in distinguishing between them; but occasionally some peculiar company is encountered which is hard to classify. Moreover, ambiguous expressions may sometimes be used in statutes, wills, contracts, and so forth, which leave a doubt whether they were intended to apply to both or to one only of these two great divisions of corporations. For instance, in England, it is held that a company incorporated under a general law is not within a power given to trustees to invest in the securities of a "company incorporated by Act of Parliament."¹ But in America, a corporation organized under a general enabling act has been held to be a company "chartered by law."² The provision in the National Bankruptcy Act exempting from its provisions "banks incorporated under state or territorial laws" clearly applies to a company incorporated for banking purposes under a state statute providing for the formation of corporations for any lawful purpose but containing no particular provisions for the regulation of banks.³ Where an act of the legislature consolidating two corporations does not create a new corporation, but merely enables one of the old companies to absorb the other, the amalgamated company is not "incorporated by Act of Parliament."⁴

§ 24. **Under what Statute Corporation is deemed to be formed.** — Where corporations are classified with respect to the statutes under which they are respectively incorporated, a company

¹ *Re Smith* (1896), 2 Ch. 590.
But see *Elve v. Boynton* (1891),
1 Ch. 501.

² *Lindsay, etc. Co. v. Mullen*,
176 U. S. 126, 136-137; 20 Sup. Ct.
325.

³ *Oregon Trust & Savings Bank*,
156 Fed. 319.

⁴ *Elve v. Boynton* (1891), 1 Ch. 109.

501, 508. Compare the American cases on the question whether a special act amendatory of a company's charter is within a constitutional provision prohibiting incorporation by special act: *Wallace v. Loomis*, 97 U. S. 146, and 1 Clark & Marshall on Priv. Corps., pp. 108,

whose incorporation paper states that the organization is under one statute whereas the objects as set forth in the instrument bring the company within another statute, is to be classed as a company incorporated under the last mentioned statute.¹

§ 25. **Classification with respect to Liability of Members.** — Another classification — more useful in England than in the United States — is based on the extent of the members' liability for the company's debts. The British law permits, in the first place, the incorporation of companies with unlimited liability; but, as may readily be understood, companies of this sort are rarely formed. The same statute authorizes the formation of "companies limited by guarantee" — that is, companies in which the liability of their members is limited to such amount as the members respectively undertake to contribute to the assets of the company in the event of the same being wound-up. Companies of this class are also comparatively uncommon. In by far the most usual class of companies, even in England, the liability of the members is limited to the amount, if any, unpaid on the shares respectively held by them. Companies of this class are called in England "companies limited by shares." The first of these three classes of corporations — that is, companies with unlimited liability — may exist in some few of the United States; but in this country generally they are not met with, and their number is not likely to increase. The second class, or companies limited by guarantee, are nearly if not quite unknown in America. The great majority of business corporations, in the United States as well as in England, belong to the third class, or companies limited by shares. Corporations of this sort are in this country called joint-stock corporations. This term is, to be sure, somewhat indefinite, since it would include joint-stock companies incorporated without limited liability; but it is convenient and sufficiently accurate for all practical purposes. In America, some liability in addition to the liability to contribute to the capital the amount, if any, unpaid on the shares, is frequently imposed by statute; but these statutory liabilities are always limited in amount so that they do not destroy the character of the corporations as limited liability companies.

¹ *International Boom Co. v. Rainy Lake River Boom Co.*, 97 Minn. 513; 107 N. W. 735. Cf. *infra*, § 63.

§ 26-§ 29. *Classification with respect to Objects.*

§ 26. **Ancient Classification.** — The old classification of corporations with reference to their objects as civil and eleemosynary, ecclesiastical and lay,¹ may now be regarded as obsolete, at least in America; but the purposes or objects of corporations still constitute convenient criteria for classifying corporations and for distinguishing between them.

§ 27. **How Objects determined for Purposes of Classification.** — When a classification of corporations with respect to their objects or purposes is employed, reference may be had either to the objects which the company is actually pursuing or to those which it is authorized to pursue. Thus, in order to determine whether a corporation is within the classes of companies which are subject to the United States Bankrupt Act of 1898, regard must be had to the business which the company is in fact carrying on and not to that which it is authorized to carry on by its charter or incorporation paper.² On the other hand, in order to determine whether a company is a manufacturing company within the Minnesota laws which exempt the shareholders in such companies from liability to creditors, the terms of the incorporation paper and not the business which the company in fact conducts must control.³ So the question whether a certain corporation is a charitable corporation within the meaning of the rule which exempts charitable corporations from liability for the torts of their servants must be determined exclusively from the incorporation paper.⁴

§ 28. **Municipal Corporations, Religious and Charitable Corporations, Public-service Corporations, Financial Corporations, etc.** — In classifying corporations with respect to their objects,

¹ 1 Black. Comm. 470.

Frisk-Turner Co., 71 Minn. 413;

² *Tontine Surety Co.*, 116 Fed. 401; *New York, etc. Water Co.*, 98 Fed. 711; *Chicago-Joplin Lead & Zinc Co.*, 104 Fed. 67.

74 N. W. 160; 70 Am. St. Rep. 334.

But see *Quimby Freight Forwarding Co.*, 121 Fed. 139 (where the court refused to regard an *ultra vires* business as the main business).

⁴ *Gitzhoffen v. Sisters of Holy Cross Hospital Ass'n* (Utah), 88 Pac. 691, 694-695; *Craig v. Benedictine Sisters Hospital Ass'n*, 88 Minn. 535; 93 N. W. 669.

³ *First Nat. Bank v. Converse*, 200 U. S. 425; 26 Sup. Ct. 306; *Gould v. Fuller*, 79 Minn. 414; 82 N. W. 673; *Nicollet Nat. Bank v.*

Cf. *People ex rel. Board of Charities v. N. Y. Society for Prevention, etc.*, 161 N. Y. 233, 239-240; 55 N. E. 1063 (as to what corporations are subject to visitation as charitable corporations).

municipal corporations, or corporations formed to act as governmental agents of the state, may for our present purpose be put on one side. So, too, religious and charitable corporations belong in a class to themselves, and are rarely or never formed on the joint-stock principle. The only class of corporations with which we are now directly concerned consists in companies incorporated for the acquisition of gain for their members, or, to use a popular term, "business corporations."¹ Even of these, those that are organized for carrying on some public calling, such as railway and canal companies, gas, electric light, and telegraph companies — in a word public service corporations — are governed, in some respects, by reason of their semi-public character, by principles of law in many respects peculiar to themselves. From these peculiar features of the law of public-service corporations, the general law of corporations is quite distinct. Furthermore, some corporations that cannot fairly be classified as public-service companies are organized for the transaction of a financial business,² such as banks and trust companies, and in a less degree insurance and guaranty companies, so that some peculiar regulations to secure their depositors, *cestuis que trust*, and policy-holders are and should be imposed upon them; and with these peculiar regulations we shall have nothing to do. Our consideration shall be confined to the principles of law applicable to all joint-stock corporations, limited by shares, and organized for the acquisition of gain.

§ 29. "Public" and "Private" Corporations. — A classification of corporations which is much used in America divides them into public and private corporations. Public corporations include municipal corporations, and others formed as govern-

¹ The term "business corporations" includes railway companies, *Adams v. Boston, etc. R. R. Co.*, 1 Fed. Cas. 90; *Winter v. Iowa, etc. Ry. Co.*, 2 Dill. 487 (headnote inadequate); and also insurance companies, *Hercules Mut. Life Ass. Soc.*, 12 Fed. Cas. 12; but not educational corporations even though they charge for tuition, *McLeod v. Lincoln Med. College* (Nebr.), 96 N. W. 265, 266. A railroad company is a "commercial corporation."

Sweatt v. Boston, etc. R. R. Co., 23 Fed. Cas. 530, 535.

As to what is a corporation formed for profit, see *State v. Home Co-operative Union*, 63 Ohio St. 547; 59 N. E. 220; *People v. Rose*, 188 Ill. 268; 59 N. E. 432; *American Matinee Ass'n v. Secretary of State*, 104 N. W. 141; 140 Mich. 579.

² For cases construing the phrase "moneyed corporations," see that title in *Words and Phrases Judicially Defined*, Vol. V, p. 4569.

mental agents of the state. Private companies, on the other hand, are all corporations organized in whole or in part for private objects or under the control of private individuals. In this sense, all railroad and other public service companies are private corporations. In England, the terms "public" and "private" are not applied to corporations in this sense. For example, any company incorporated under the Companies Acts, its constitution being matter of record and open to public inspection, may in one sense be deemed a public company.¹ But the term public, as distinguished from private, company has acquired in popular English usage a quite different signification. A private company, in this popular sense, is a company whose shares are not intended for public subscription; any other company is a public company.² This meaning is not attached to these terms anywhere in the United States.

§ 30. **Nomenclature — "Corporations" and "Companies."** — In America, we speak of any association of individuals, incorporated or unincorporated, as a company. In England, the latter term is generally applied to associations organized for the transaction of some ordinary business. It is the usual name for what in America would be more commonly termed a private corporation.

Of course, in America we recognize that our ordinary corporations are companies;³ and indeed the word "company"

¹ Cf. *Rickett v. Sharpe*, 45 Ch. D. 286; *Re Lysaght* (1898), 1 Ch. 115.

² Palmer's *Company Law*, 3d ed., 260-261; *British Seamless Paper Box Co.*, 17 Ch. D. 467, 479.

Cf. *Lamonby v. Carter* (1903), 1 Ch. 352 (where the phrase "public companies" in a will of an English testator was held to refer exclusively to British companies); *Innes & Co.* (1903), 2 Ch. 254, 266 (where Cozens-Hardy, L. J., said: "On principle, it is not easy to appreciate the distinction between a private company and a public company"); *Carr v. Griffith*, 12 Ch. D. 655 (where

the words "public company" in the Apportionment Act of 1870 were held to include an unincorporated joint-stock company established in 1843, before the passage of the first Companies Act, under a deed of settlement). See also Companies Act, 1907, § 37, where a legislative definition or interpretation of the words "private company" will be found.

³ Cf. *Van Horne v. State*, 5 Ark. 349, 352 (headnote inadequate); *Gillig, Mott & Co. v. Independent Gold, etc. Co.*, 1 Nev. 247.

has been thought to import a corporation¹ although a large number of American cases, supported by legal reasoning as well as by literary and popular usage, hold that the word is equally applicable to some unincorporated associations.² A municipal corporation is not properly included within the term "incorporated company."³

So, Englishmen recognize that their companies are corporations. But as a matter of popular nomenclature the term corporation is in more general use here, while the term company is in more general use in England. For instance, we speak in America of corporation law while an Englishman calls the same branch of jurisprudence company law. It has been held

¹ *Broome v. Galena, etc. Packet Co.*, 9 Minn. 239; *Commonwealth v. Reinoehl*, 163 Pa. St. 287; 29 Atl. 896; 25 L. R. A. 247.

Cf. *State v. Stone*, 118 Mo. 388, 397-399; 24 S. W. 164; 25 L. R. A. 243; 40 Am. St. Rep. 388; *Goddard v. Chicago, etc. Ry. Co.*, 202 Ill. 362, 369; 66 N. E. 1066.

² *Singer Mfg. Co. v. Wright*, 33 Fed. 121, 127 (headnote inadequate); *State v. Stone*, 118 Mo. 388; 24 S. W. 164; 25 L. R. A. 243; *Bradley Fertilizer Co. v. South Publishing Co.*, 4 N. Y. Misc. 172, 176 (headnote inadequate); 23 N. Y. Supp. 675; *Lee Mut. Fire Ins. Co. v. State*, 60 Miss. 395 (where the words "company" and "association" were declared to be synonymous); *State v. Mead*, 27 Vt. 722; *Gillig, Mott & Co. v. Independent Gold, etc. Co.*, 1 Nevada, 247, 249.

Cf. *Mills v. State*, 23 Tex. 295 (construing the word "company" in a statute as applying only to associations composed of a large number of persons and acting through officers and not to an ordinary co-partnership); *Palmer v. Pinkham*, 33 Me. 32, 36. ("The proper signification of the word 'company,' when applied to persons engaged in trade, denotes those united for the same purpose or in a joint concern. It is so commonly

used in this sense or as indicating a partnership that," etc.)

The word "company" has even been held to apply to an individual. *Efland v. Southern Ry. Co.*, 59 S. E. 355, 357; *Singer Mfg. Co. v. Wright*, 97 Ga. 114, 119-122 (headnote inadequate); 25 S. E. 249; 35 L. R. A. 497; *Singer Mfg. Co. v. Wright*, 33 Fed. 121, 127 (semble); *Chicago Dock Co. v. Garrity*, 115 Ill. 155, 164 (headnote inadequate); 3 N. E. 448. But this meaning is quite foreign to the word itself and can only be adopted in order to carry out the intent as collected from the context. Cf. *Goddard v. Chicago, etc. Ry. Co.*, 202 Ill. 362, 369; 66 N. E. 1066.

³ *Kansas City v. Vineyard*, 128 Mo. 75; 30 S. W. 326.

Cf. *Smith v. City of Janesville*, 52 Wisc. 680, 682 (headnote inadequate); 9 N. W. 789 (where the phrase "corporations and companies" was held not to include municipal corporations on the ground that "companies" could only denote private associations of persons for the prosecution of some enterprise, while the generality of the word "corporations" should be restrained by the principle of *noscitur a sociis*); *Charlottesville v. Southern Ry. Co.*, 97 Va. 428, 431 (headnote inadequate); 34 S. E. 98.

in England that an "industrial and provident society," although a corporation, is not a *company*.¹ On the other hand, Buckley, J., in a recent case gave a definition of a company which is equally applicable in the United States. "The word 'company,'" said he, "has no strictly technical meaning. It involves, I think, two ideas — namely, first that the association is of persons so numerous as not to be aptly described as a firm; and secondly, that the consent of all the other members is not required to the transfer of a member's interest. It may * * * include corporation."²

¹ *Great Northern Ry. Co. v. Coal Co-operative Soc.* (1896), 1 Ch. 187, Ch. 131, 134.
² *Tennant v. Stanley* (1906), 1 194.

CHAPTER II

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§ 31. **Name of Instrument.** — All, or almost all, general laws for the formation of incorporated joint-stock companies resemble each other in this, that the formal organization of a corporation thereunder is commenced by the promoters by signing and depositing for record a document which states the name and purposes of the company, the amount of its capital, and in some other particular outlines the fundamental constitution of

the corporation. This document is variously termed in different localities. Under the first English general incorporation law it was called a "deed of settlement"; but this term is no longer in use on either side of the Atlantic. In some of the American states it is called "articles of association"; but that term is ambiguous and objectionable, because in England it bears a totally different signification, designating, as already stated, regulations for the company's management which partake of the nature of mere by-laws.¹ The term "articles of incorporation" is sometimes used, but this likewise is objectionable, because the word "articles" may lead to confusion with the English "articles of association," — a phrase popularly abbreviated in England to "articles," — which, as just mentioned, have a very different nature and office. In some of the United States the document is called a "certificate of incorporation"; but that name too is unfortunate, for it is applied also — and with much appropriateness — to a certificate issued by some public officer stating or certifying that the requirements of the law have been complied with in the formation of a certain company, and that the company is therefore a corporation. The term "charter" is sometimes used in America;² but this use is popular rather than legal,³ and is not to be commended. A charter, in English law, properly denotes an instrument which confers special privileges; and while in America it is perverted from its original meaning so as to include a legislative grant of corporate privileges by a special act of incorporation⁴ as well as a royal charter, — its primary signification, — yet it cannot, except by a figure of speech, be applied to a paper drawn up in pursuance of a general law that offers the same privileges to all persons upon the same terms. The name which is now used in England is "memorandum of association." It does not seem to have gained currency in America; but it is unambiguous and appropriate. The only objection that might be urged against the propriety of this designation is that the word "memorandum" may seem to

¹ Supra, § 11, and infra § 683.

² See *New Orleans Nat. Banking Ass'n v. Wiltz*, 10 Fed. 330; *Cuyler v. City Power Co.*, 74 Minn. 22; 76 N. W. 948; *Red Men's Mutual Relief Ass'n*, 10 Phila. 546.

³ In some states, however, "char-

ter" is the name used by the legislature in the incorporation law. See *Kaiser v. Lawrence Sav. Bank*, 56 Iowa, 104, 105; 8 N. W. 772; 41 Am. Rep. 85.

⁴ Cf. supra, § 4, as to English usage.

imply a less formal document than one which constitutes the very foundation and charter of a corporation's existence, and which is or should be drawn up with the greatest possible care and formality. A colorless and unobjectionable name is "incorporation paper." As this term does not seem to have been used in any state or country as a special designation of the instrument under the local laws, it commends itself by virtue of its very generality, and is accordingly used throughout this work.

§ 32-§ 36. *Function of Instrument.*

§ 32. **In general.** — The importance of this paper can hardly be exaggerated. It takes the place of, and in America, as we have seen, is sometimes called, a charter of incorporation. It delineates the limits of the company's powers, and the exercise of any power for which authority, express or implied, cannot be found in this instrument is *ultra vires* of the corporation. It marks out not merely the powers and objects of the company, but also in some measure the means by which those objects may be pursued. Thus, it prescribes the amount of the capital stock and the number of shares into which it is divided. It is the constitution of the corporation, and, subject only to the laws of the land, the supreme law of its government and being. "The memorandum of association is as it were the area beyond which the action of the company cannot go."¹

§ 33. **Dual Nature — A statutory Condition and a private Contract.** — An incorporation paper, or memorandum of association, has a double function. In the first place, it operates as a compliance with the statutory conditions necessary to secure the benefits of corporate existence; it is a talisman, an *open-sesame*, required by sheer force of positive law. In the second place, it is a private contract between the members of the company, and performs the same function as the articles of partnership of an ordinary firm, or, to use a still closer analogy, of an unincorporated joint-stock company. In this aspect, the instrument derives its efficacy, not from the incorporation law or companies act, but from the common law of contracts, of copartnerships and joint enterprises; and accordingly its provisions are effective to the same extent as similar provisions in

¹ *Ashbury Ry. Carriage Co. v. Riche*, 7 H. L. 653, 671, per Lord Cairns.

the articles of agreement of a copartnership or unincorporated joint-stock company, except in so far as the statute under which the company is incorporated may otherwise provide. This second aspect and function of a memorandum of association or incorporation paper is sometimes lost from sight; and in consequence of such a one-sided view there arises a narrowness of construction which deprives the people of that elasticity in corporate organization which modern incorporation laws, fairly construed, ought to secure. Happily this one-sided, partial view of the subject, which is a survival of the old conception of all corporations as chartered monsters, is much less common now than formerly. The English courts have never confused the modern incorporated partnerships formed under general incorporation laws with the old chartered corporations; and but few of the American courts still fail to recognize the true breadth and significance of this distinction. The dual nature of a memorandum of association or incorporation paper is fundamental.

§ 34. *Instrument as a Contract.* — An incorporation paper is, therefore, properly referred to as a contract. Indeed, it is a bundle of contracts.

§ 35. *As a Contract with the State.* — In the first place, it is said to be a contract by the State with the incorporators. This notion originated with royal charters of incorporation, which might not inaptly be deemed grants or contracts by the sovereign,¹ and was then applied to special acts of incorporation, and has finally been extended to incorporation papers under general laws.² With almost equal propriety, ordinary articles of partnership might be said to be a contract between the state and the partners. However, the aspect of an incorporation paper as a contract between the incorporators and the state pertains to the domain of constitutional law, and therefore need not be further considered in this work.

§ 36. *As Contract between Subscribers or Shareholders.* — In the second place, every incorporation paper is indubitably a contract in the strictest sense between the several signatories,

¹ *Dartmouth College v. Woodward*, v. State, 15 Wall. 478, 492 (semble); 4 Wheat. 518. *Garey v. St. Joe Mining Co.* (Utah),

² *Chicago, etc. R. R. Co. v. Iowa*, 91 Pac. 369. 94 U. S. 155, 161 (semble); *Miller*

and between the persons who may subsequently become shareholders.¹ A section of the English Companies Act, which has been referred to above, provides that the several members of the company shall be bound by the memorandum of association to the same extent as if they had signed and sealed it, and as if it had contained a covenant on their part to abide by its terms. But this express provision is declaratory merely, except in so far as by virtue of its provisions the several shareholders are bound as by a specialty whereas otherwise they would be bound by simple contract merely. But even according to this emphatic and express provision of the British statute, the shareholders are bound, probably, only in their capacity as shareholders. At all events, the document is only a contract between the shareholders *inter sese*, and gives no right of action to a stranger against the company.²

§ 37-§ 44. RULES FOR CONSTRUCTION OF INSTRUMENT.

§ 37. *In general.* — The general principles of construction applicable to these incorporation papers are not very fully worked out in the decisions, probably because those principles do not greatly differ from the rules for the interpretation of other written instruments or contracts. Thus, as in the case of other written instruments, the construction of an incorporation paper is for the court rather than the jury.³

§ 38-§ 40. *Applicability of Rules for Construction of Special Acts of Incorporation.*

§ 38. *In general.* — As an incorporation paper stands in the place of a special act of incorporation, either one being a company's fundamental constitution and marking out the objects and purposes of its existence, the rules of construction which

¹ *Loewenthal v. Rubber Reclaiming Co.* 52 N. J. Eq. 440; 28 Atl. 454; *Garey v. St. Joe Mining Co.* (Utah), 91 Pac. 369, where it was said that the instrument is a contract between the corporation and the stockholders.

² Cf. *Eley v. Positive, etc. Ass. Co.*, 1 Ex. D. 88; *Browne v. La Trinidad*, 37 Ch. D. 1, 13; *Glass v. Pioneer*

Rubber Works, 31 Vict. L. R. 754. These cases related to "articles of association"; but precisely the same principles in this respect would apply to a memorandum of association or incorporation paper. For the similar rule with regard to by-laws see *infra*, § 737.

³ *Groeltz v. Armstrong Real Estate Co.*, 89 N. W. 21; 115 Iowa 602.

have become established with reference to special acts of incorporation, will naturally be looked to as authority for the construction of incorporation papers under general laws.¹ This is not merely natural but also justifiable and indeed necessary. Yet the differences between the two classes of instruments should not be disregarded.² A special act of incorporation is a statute; an incorporation paper under general law is a private contract. The one is the language of the state, speaking by its legislature; the other is the language of the individual corporators or promoters. Consequently, in the construction of the former the intention of the legislature so far as ascertainable from the language employed should govern; in the construction of the latter, the intention of the corporators is in like manner controlling.³

§ 39. **Whether Instrument should be construed most strongly in Favor of State.** — Now, the well-settled and cardinal rule for the construction of special acts of incorporation is that they are to be taken most strongly in favor of the public.⁴ Nothing passes from the sovereign by implication. And the reason for this rule is that the state in conferring a special act of incorporation is granting special privileges, and that the language of the legislature must always be taken most strongly in favor of their *cestuis que trust*, the people. On principle, it is difficult to see how this rule can be applicable to an incorporation paper. For the promoters by whom it is framed are not public servants, are under no duty to safeguard the interests of the public; and yet as we have seen it is their intention which the courts in con-

¹ See 1 Morawetz on Priv. Corps., 2d Ed., § 318, where the learned author asserts broadly that "the same rules of construction apply to articles of incorporation adopted pursuant to general laws, as to charters of incorporation granted by special acts of the legislature." Cf. *Rockhold v. Canton Masonic Benev. Soc.*, 129 Ill. 440, 455-456 (where the language of the court is more cautious and less sweeping than the headnote would indicate); 21 N. E. 794; 2 L. R. A. 420.

² Cf. *Atty.-Gen. v. Mersey Ry. Co.* (1907), 1 Ch. 81, 101 (a passage

quoted below p. 37 note 4); *Kingsbury Collieries and Moore's Contract* (1907), 2 Ch. 259, 266-267.

³ Cf. *Riker v. Leo*, 133 N. Y. 519; 30 N. E. 598; *Receivership of (Merchants Nat. Bank v.) Minnesota Thresher Mfg. Co.*, 95 N. W. 767; 90 Minn. 144; *Senour Mfg. Co. v. Church Paint, etc. Co.*, 81 Minn. 294, 298; 84 N. W. 109 ("The intention of the corporation must control").

⁴ *Charles River Bridge v. Warren Bridge*, 11 Pet. 420; *Proprietors of Stourbridge Canal v. Wheeley*, 2 B. & Ad. 792; *Edgewood Borough v. Scott*, 29 Pa. Super. Ct. 156.

struing the instrument must endeavor to ascertain. How can the construction of such a document, dependent upon the intention of mere private individuals, be either favorable or unfavorable to the public? It is a private matter with which the public have no concern. As well might one say that articles of partnership should be taken most strongly against the partners and in favor of the state.

§ 40. *Oregon Railway Company v. Oregonian Railway Company*. — A case of high authority which may be thought to militate against the views advocated in the last paragraph is *Oregon Railway Company v. Oregonian Railway Company*.¹ There Mr. Justice Miller in delivering the judgment of the court, after stating the rule that special acts of incorporation shall be construed most strongly in favor of the state and against the corporation, added, "How much more, then, should this rule be applied, and with how much more reason should a court, called upon to determine the powers granted by these articles of association, construe them rigidly, with the stronger leaning in doubtful cases in favor of the public and against the private corporation." And the reporter in the headnote states as one of the leading propositions for which the case stands that "this rule of construction applies with still greater force to articles of association organizing a corporation under general laws." Nevertheless, a careful examination of the case will reveal that the decision really stands for nothing of the sort. The case was this: a corporation had been formed in England under the Companies Act of 1862 by the name of the Oregonian Railway Company, having power according to its memorandum of association to construct, own, operate, and to lease, sell, or purchase lines of railway in the State of Oregon. Another company, known as the Oregon Railway Company, was formed under the general laws of Oregon, which provided for the organization of corporations for any "lawful enterprise, business, pursuit or occupation," that might be specified in the "articles of incorporation." The articles of incorporation of this latter company purported to clothe it with power to construct, purchase, or lease railways in the State of Oregon. Accordingly, the English company, having built a line of railroad in Oregon leased the same for a term of years to the Oregon company; and the

¹ *Oregon Ry. Co. v. Oregonian Ry. Co.*, 130 U. S. 1; 9 S. Ct. 409.

question was whether this lease was lawful and valid. As the incorporation papers of both the English company and the Oregon company purported expressly to confer the power to make or take leases of railways, no question arose or could have arisen in the case as to the proper rules for the construction of incorporation papers; and the only question was whether the clauses in the incorporation papers which attempted to confer these powers upon the corporations were valid and operative under the laws of Oregon. As the court itself said: "The memorandum made under the Companies' Act of 1862 by the plaintiff and the articles of association made under the laws of Oregon by the defendant both contain declarations of the powers of these companies and of each of them to buy or sell or lease railroads. The only question, therefore, to be considered is whether this declaration of power is authorized by the laws of Oregon."¹ Hence, anything that may have fallen from the court to the effect that an incorporation paper should be construed most strongly against the company and in favor of the public was altogether and confessedly *obiter*.² The proposition for which the case really stands is that a general incorporation law, like other statutes, is to be taken most strongly in favor of the state.³ For reasons already mentioned, it is submitted that this rule, which is quite proper in the interpretation of statutes, is wholly inapplicable in the construction of an incorporation paper.⁴

¹ 130 U. S. 24-25.

² The dictum was, however, referred to with approval in *Central Transportation Co. v. Pullman's, etc. Co.*, 139 U. S. 24, 49; 11 S. Ct. 478.

See also *Hamilton Nat. Bank v. American Loan, etc. Co.*, 92 N. W. 189, 192; 66 Nebr. 77; *City of Goodland v. Bank of Darlington*, 74 Mo. App. 365, 370.

³ In support of this proposition, which is clearly sound, see also, *City of Goodland v. Bank of Darlington*, 74 Mo. App. 365.

⁴ Cf. *Attorney-General v. Mersey*

Ry. Co. (1907), 1 Ch. 81, 106, where *Vaughan Williams, J.*, said, "You ought to give a wider construction to the words of a memorandum of association creating and defining the powers of a purely commercial company having no compulsory powers and no monopoly than you would give to the words of a statute creating a company, like a railway company, having compulsory powers of land purchase and a practical monopoly." This language was quoted with approval in *Kingsbury Coleries and Moore's Contract* (1907),

2 Ch. 259, 266-7.

§ 41. **Construction neither Strict nor Liberal.** — At any rate, the general principle is settled, on the one hand, that no extension of the terms of the instrument is permissible by construction, and on the other hand that its meaning is not to be restricted by a narrow interpretation. Said Vice-Chancellor Bacon in an important case upon this subject: "I wholly repudiate the notion that I am at liberty to adopt what has sometimes been called a 'liberal' construction. I have no more right to do that on the one hand than I am at liberty on the other to adopt a more rigorous or strict construction than the express stipulations of the instruments require. What the law requires and what I am called upon to do is to put a just construction, and no other, upon these instruments."¹

§ 42. **Liberal Construction to carry out ascertained Objects.** — Although when a court is endeavoring to ascertain from the incorporation paper the objects for which a corporation is formed, the construction, as we have just seen, should be neither strict nor liberal, but just; yet when the objects of the company have been determined, the tendency of the courts is, and should be, to allow the greatest possible latitude to the company in the choice of the means by which those objects are to be attained. The general rule being that all means that are reasonably conducive to the objects of the incorporation and not prohibited are permitted, the courts will not incline to extend any restrictions that the incorporation paper may contain in respect to the means that may be employed in prosecuting the company's ends. To that extent, the construction of an incorporation paper will be "liberal to carry out the purposes of the company's formation,"² but this "liberal" construction cannot be resorted to where the object of the interpretation is to discover what these purposes are.

§ 43. **Entire Instrument to be construed together.** — The entire instrument must be construed together. Hence, the corporate name may be considered in the construction of the clause

¹ *London Financial Ass'n v. Swinfen Eady, J., in Stephens v. Kelk*, 26 Ch. D. 107, 134. *Mysore Reefs (Kangundy) Mining*

² "It is right to give a liberal construction to these subsidiary paragraphs to enable the main object of the company to be carried out," per *Co. (1902)*, 1 Ch. 745, 749. Cf. *Louisville, etc. Ry. Co. v. Flanagan*, 113 Ind. 488, 495, 14 N. E. 370; 3 Am. St. Rep. 674.

prescribing the company's objects.¹ *A fortiori*, "the general object of the corporation is to be gathered not from any one of the specifications but from the whole of the paragraph" which states the objects or purposes of the company.²

§ 44. **Parol Evidence — Contemporaneous Internal Regulations as Aid in Construction.** — To aid in the construction of an incorporation paper, parol evidence it seems is admissible to the same extent and with the same restrictions as in the case of other documents formally drawn up and recorded.³ Thus, parol evidence is not admissible to show that the objects of the company were in fact incorrectly or inadequately set out in the incorporation paper.⁴ To be sure, English judges have gone so far as to declare that in construing a memorandum of association contemporaneous articles of association "may be properly considered for the purpose of explaining the terms and expres-

¹ See *infra* § 62, § 117 and § 462. But cf. *International Boom Co. v. Rainy Lake River Boom Co.*, 97 Minn. 513; 107 N. W. 735.

² *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 239; 23 Atl. 287.

³ "If any doubt arises as to the true intent and meaning of the words employed, it is essentially requisite that the subject to which the words relate should be distinctly understood; and to this end it may at all times be convenient, and in some cases necessary, to have regard to the circumstances attending and relating to the subject, to the interests comprised in it, to the parties to it, and most especially to its avowed, expressed and of necessity implied, objects. Upon these principles and rules I am called upon to construe this memorandum." Per Bacon, V. C., in *London Financial Ass'n v. Kelk*, 26 Ch. D. 107, 134.

Cf. *Receivership of (Merchants' Nat. Bank v.) Minnesota Thresher Mfg. Co.*, 95 N. W. 767; 90 Minn. 144; *Senour Mfg. Co. v. Church Paint, etc. Co.*, 81 Minn. 294; 84 N. W. 109; *National Mechanical Directory Co.*, 121 Fed. 742; 58

C. C. A. 24; *Rehbein v. Rahr*, 109 Wisc. 136, 145-146; 85 N. W. 315.

⁴ *Craig v. Benedictine Sisters Hospital Ass'n*, 88 Minn. 535; 93 N. W. 669; *Gitzhoffen v. Sisters of Holy Cross Hospital Ass'n (Utah)*, 88 Pac. 691, 694-695; *City of Kalamazoo v. Kalamazoo, etc. Power Co.*, 124 Mich. 74, 81-82 (attempt to limit by parol evidence general objects expressed in incorporation paper). Doubtless this rule would not apply in a proceeding by the state to oust the company from its franchises on the ground that the real objects were unlawful. See *infra*, § 300.

Cf. *Attorney-General ex rel. Miner v. Lorman*, 59 Mich. 157; 26 N. W. 311; 60 Am. Rep. 287; *State v. New Orleans Water Supply Co.*, 36 So. 117, 122; 111 La. 1049 ("The question whether a corporation has been organized for an illegal purpose must be determined by the provisions of its charter and not by the declarations of its officers or agents"); *Detroit Driving Club v. Fitzgerald*, 109 Mich. 670, 675; 67 N. W. 899 ("The purposes of the corporation or association are to be determined by the statement in its articles of association.").

sions of the memorandum whenever it is just and reasonable so to refer.”¹ But, as it is well settled that the articles of an English corporation cannot in any way add to or control the memorandum, any resort to the articles to aid in its construction is dangerous in the extreme, and has been disapproved by one of the ablest of modern English judges.² A recent case intimates that reference to the contemporaneous articles is permissible only for the purpose of construing those parts of the memorandum of association which relate to matters not required by the statute to be stated in that instrument.³ The question is perhaps of but little practical importance in the United States; for the by-laws of an American company which perform in some ways the same functions as English articles of association are not, like the latter, matter of public record; and therefore, whatever may be the case with respect to English articles, it will hardly be contended that by-laws, even if drawn up contemporaneously with the incorporation of the company, can be used in any way as a key to the meaning of the incorporation paper.⁴

§ 45. **Division of Instrument into Paragraphs or Clauses.**—An incorporation paper is usually divided into paragraphs or clauses, each of which contains some statutory requirement. Thus, we may distinguish the object clause, the capital clause, the chief-office clause, and so forth.

¹ *London Financial Ass'n v. Kelk*, introduced for the benefit of the 26 Ch. D. 107, 135, 138; *Fisher v. Black & White Publishing Co.* (1901), 1 Ch. 174, 180–182 (per Vaughan Williams, J.).

² “I shall only say a few words as to how far, in my opinion, the articles of association may be looked at and read together with the memorandum of association. . . . There is an essential difference between the memorandum and the articles. The memorandum contains the fundamental conditions upon which alone the company is allowed to be incorporated. They are conditions

introduced for the benefit of the creditors, and the outside public as well as the shareholders. The articles of association are the internal regulations of the company. How can it be said that in all cases the fundamental conditions of the charter of incorporation, and the internal regulations of the company are to be construed together.” Per Bowen, L. J., in *Guinness v. Land Corporation*, 22 Ch. D. 349, 381.

³ *Southern Brazilian, etc. Ry. Co.* (1905), 2 Ch. 78, 84.

⁴ See *Xantha Beneficial, etc. Ass'n*, 8 Pa. Dist. Rep. 142.

§ 46-§ 108. THE OBJECT CLAUSE.

§ 46. **Function of Object Clause.**—No part of an incorporation paper is more important or deserves greater attention than the object clause, in which the purposes or objects of the company are set forth. In England, it is held that common law corporations — that is, corporations created by royal charter — have power to do anything that an ordinary individual may do except in so far as they may be restrained or restricted by direct prohibition;¹ but on the other hand, it is held that corporations incorporated by special act of the legislature possess such powers only as are authorized expressly or impliedly by the special act in question,² and that corporations incorporated under general laws possess only such powers as are conferred by the general law or are necessary to the attainment of the objects specified in the incorporation paper.³ There has been some difference of opinion in England whether this doctrine as to companies incorporated under general laws is due to the fact that a company of that class is a corporation only for the purposes stated in its incorporation paper or to the fact that the exercise of any power which is not incidental to the objects as expressed in the incorporation paper is either expressly or impliedly prohibited by the legislature;⁴ but this question, which is known as the question of general or special capacity, is largely if not altogether a matter of words.⁵ At any rate, the doctrine as to common law or royal-charter corporations (which with the exception of one or two survivals, such as Dartmouth College, are non-existent in America), is a matter of only antiquarian and academic interest in the United States; and as to

¹ *Attorney-General v. Manchester Corporation* (1906), 1 Ch. 643 (head-note inadequate). See also *infra*, § 1022-§ 1026.

² *Wenlock v. River Dee Co.*, 10 A. C. 354.

³ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653.

⁴ 1 *Palmer's Company Precedents*, 9th ed., 370-371; *Pollock on Contracts*, 6th ed., 674-683.

⁵ "Practically, it makes very little difference whether we say that

the railway company has no authority given to it by its incorporation to enter into contracts not connected with its corporate duties, or that it is impliedly prohibited from so doing because by necessary inference the legislature must be considered to have intended that no such contracts should be entered into." Per Lord Cranworth in *Shrewsbury, etc. Ry. Co. v. North-Western Ry. Co.*, 6 H. L. Cas. 113, 137.

corporations created by special act of the legislature or formed under general laws the American cases are in entire accord with the English authorities and hold that the corporations possess such powers only as are conferred upon them, expressly or impliedly, by the statute or the incorporation paper.¹

§ 47. **Comparative Advantages of Broad and Narrow Statements of Objects.** — In the preparation of the object clause of an incorporation paper the fact should be borne in mind that any objects not mentioned therein will be *ultra vires* of the corporation and cannot be pursued against the opposition of a single shareholder and, in theory at least, not even by unanimous consent. Hence, if the object clause is too narrow the company may find its operations seriously hampered. On the other hand, if the objects are stated too broadly, the power of the majority is almost unlimited and may serve to deter conservative investors from putting their capital in the concern. Yet, at least from the point of view of the promoters, who usually expect to constitute the majority of the corporation, the balance of inconvenience lies decidedly in having the objects too closely circumscribed.² Accordingly, in recent years the approved practice has been to use a very broad and elaborate and often rather verbose statement of objects.³ On the other hand, as will be more fully explained below, a very general statement of objects may be too indefinite to satisfy the law.⁴

§ 48—§ 63. WHAT OBJECTS ARE AUTHORIZED BY INCORPORATION LAW TO BE EXPRESSED IN OBJECT CLAUSE AS PURPOSE OF INCORPORATION.

§ 48. **Under Statutes Specifying Objects for which alone Companies may be incorporated.** — The objects of the company as

¹ *Downing v. Mount Washington Dry Dock Co.*, 28 La. Ann. 173; *Road Co.*, 40 N. H. 230; *State v. Best Brewing Co. v. Klassen*, 185 Ill. 37; 57 N. E. 20; 76 Am. St. Rep. 26; 50 L. R. A. 765.
² "The balance of disadvantage decidedly attaches to too narrowly defined objects." Dill on New Jersey Corporations (3d ed.), § 8, p. 19.
³ Cf. *Consett Iron Co.* (1901), 1 Ch. 236 (headnote inadequate). See also *infra*, § 65.
⁴ *Infra*, § 104—§ 106.

expressed in the incorporation paper must, of course, be authorized by the general law or enabling act under which the company is organizing. The earlier American statutes authorized the formation of corporations of certain particular kinds or classes only. Under such statutes, it was, — or rather is, for they still remain in force in some few of the States — imperatively necessary that the objects of the proposed corporation should be brought within some of these classes. Thus, if a statute authorized the formation of manufacturing corporations, the organization of a company to engage in the business of buying and selling merchandise would be impossible.¹ A

¹ Cf. *Meen v. Pioneer Pasteurizing Co.*, 90 Minn. 501; 97 N. W. 140 (where a company formed for "buying, manufacturing and dealing in milk, cream, butter, cheese, and other dairy products and pasteurizing and treating said milk," etc., was held not to be an exclusively manufacturing or mechanical corporation). As to what is a "manufacturing corporation," see further, *Bolton v. Nebraska Chicory Co.*, 96 N. W. 148; 69 Nebr. 681; *Receiver-ship of (Merchants' Nat. Bank v.) Minnesota Thresher Mfg. Co.*, 95 N. W. 767; 90 Minn. 144; *Bernheimer v. Converse*, 27 Sup. Ct. 755; *Cuyler v. City Power Co.*, 74 Minn. 22; 76 N. W. 948; *Nicollet Nat. Bank v. Frisk-Turner Co.*, 71 Minn. 413; 74 N. W. 160; 70 Am. St. Rep. 334; *Carlsbad Water Co. v. New*, 33 Colo. 389; 81 Pac. 34; *West Norfolk Lumber Co.*, 112 Fed. 759; *Attorney-General ex rel. Miner v. Lorman*, 59 Mich. 157; 26 N. W. 311; 60 Am. St. Rep. 287; *Commonwealth v. Keystone Electric, etc. Co.*, 193 Pa. St. 245; 44 Atl. 326; *Powell v. Murray*, 3 N. Y. App. Div. 273; 157 N. Y. 717; 53 N. E. 1130 (manufacturing company no power to deal in products manufactured by other companies); *Frederick Electric Light, etc. Co. v. Mayor, etc. of Frederick City*, 84 Md. 599; 36 Atl. 362; 36 L. R. A. 130 (electric light company distinguished from

manufacturing company); *First Nat. Bank v. William R. Trigg Co.* (Va.), 56 S. E. 158.

As to what is a "trading corporation," see *Pocono Spring, etc. Co. v. Am. Ice Co.*, 64 Atl. 398; 214 Pa. 640.

As to what is a manufacturing, mercantile, or trading (or, after 1901, mining) corporation, consult the cases as to what corporations may be adjudged bankrupts under the Bankrupt Act of 1898 and the amendatory statute of 1901. In the following cases corporations have been held to be within the Act: *First Nat. Bank v. Wyoming Valley Ice Co.*, 136 Fed. 466 (company dealing in ice partly of its own harvesting and partly bought from other persons, held to be engaged chiefly in trading and mercantile pursuits); *Troy Steam Laundering Co.*, 132 Fed. 266 (laundry company the largest part of whose business consists in laundering collars and cuffs for manufacturers held to be engaged principally in manufacturing); *Marine Construction & Dry Dock Co.*, 130 Fed. 446; 64 C. C. A. 648 (company engaged in constructing boats and also boilers, masts, desks, etc., for vessels held engaged principally in manufacturing); *Columbia Ironworks v. National Lead Co.*, 127 Fed. 99; 62 C. C. A. 99 (corporation engaged in building iron vessels held engaged in manufacturing and mer-

statute providing for incorporation for purposes "of trade or of carrying on any lawful mechanical, manufacturing, or agricultural business," will authorize the formation of a corporation to buy, sell, improve, and lease real estate.¹ Under a law authorizing the formation of corporations for "hunting, fishing, bathing or lawful sporting purposes," a company cannot be

mercantile pursuits); *White Mountain Paper Co.*, 127 Fed. 643; 62 C. C. A. 369 (corporation formed for manufacturing paper held engaged in manufacturing although it had never completed the manufacture of any paper); *Mutual Mercantile Agency*, 111 Fed. 152 (mercantile agency publishing a book for ratings); *Tecopa Mining & Smelting Co.*, 110 Fed. 120 (Mining and smelting held to be manufacturing. But compare Act of 1901 which expressly added "mining" to the classes of corporations within the act); *Morton Boarding Stables*, 108 Fed. 791 (company keeping a "boarding stable" held engaged in trading or mercantile pursuits); *Quincy Granite Quarries Co.*, 147 Fed. 279 (quarry company held engaged in mining and manufacturing); *Burdick v. Dillon*, 144 Fed. 737; 75 C. C. A. 603 (quarrying held to be included within the term mining); *First Nat. Bank*, 152 Fed. 64 (building concrete arches and bridges, and dressing stone held to be manufacturing).

In the following cases companies have been held not to be within the Act: *U. S. Hotel Co. v. Niles*, 134 Fed. 225; 67 C. C. A. 153 (hotel company); *Bay City Irrigation Co.*, 135 Fed. 850 (company for irrigation of rice fields); *Butt v. Mac-Nichol Construction Co.*, 140 Fed. 840; 72 C. C. A. 252 (company for construction of bridges, wharves, etc.); *Snyder & Johnson Co.*, 133 Fed. 806 (company soliciting advertisements for newspapers); *Surety Guarantee & Trust Co.*, 121 Fed. 73; 56 C. C. A. 654 (buying and selling stocks, bonds, and other securities, not trading or mercantile pursuit);

Quimby Freight Forwarding Co., 121 Fed. 139 (forwarding company also engaged in buying and selling); *Parmelee Library*, 120 Fed. 235; 56 C. C. A. 583 (circulating library company); *White Star Laundry Co.*, 117 Fed. 570 (laundry company); *Tontine Surety Co.*, 116 Fed. 401 (corporation authorized to deal in diamonds which had contracted to deliver a diamond on payment of a certain sum, but which had never purchased, owned, or delivered a diamond, not engaged in trading or mercantile pursuits); *New York, etc. Water Co.*, 98 Fed. 711 (water-supply company); *Cameron Town, etc. Ins. Co.*, 96 Fed. 756 (insurance company); *Chesapeake Oyster, etc. Co.*, 112 Fed. 960 (saloon and restaurant company); *Woodside Coal Co.*, 105 Fed. 56 (Coal mining company. Note that mining corporations are now expressly included by Act of 1901); *New York, etc. Ice Lines*, 147 Fed. 214; 77 C. C. A. 440 (ice company selling ice of its own harvesting); *T. E. Hill Co.*, 148 Fed. 832 (building of concrete piers and abutments for bridges held not manufacturing); *Toledo Portland Cement Co.*, 156 Fed. 83 (corporation which was formed to manufacture cement but which had not completed its buildings nor its railroads from them to the marl beds from which it was to obtain its materials, held not "engaged" in manufacturing cement).

As to classification of corporations with reference to their objects, see also *supra*, § 26-§ 29.

¹ *Finnegan v. Noerenberg*, 52 Minn. 239, 245; 53 N. W. 1150; 38 Am. St. Rep. 552.

organized to enforce the game laws and, as informer, collect fines for their violation.¹ A corporation for the purpose of buying and selling bonds cannot be formed under a statute authorizing incorporations "for the purpose of buying and selling merchandise and conducting mercantile operations."² A corporation cannot be formed to deal in rice as an article of commerce under a statute authorizing the formation of corporations for growing, purchasing, and selling seeds for agricultural purposes.³ Laws providing for the incorporation of companies to aid in the industrial or productive interests of the country have been held, by a rather liberal construction, to authorize the formation of street railway or tramway companies.⁴ When the objects for which corporations could be formed were few, it was a comparatively easy matter to determine whether the objects of the proposed company were, or were not, within the statute, even where the act allowed incorporation for certain specified purposes only. But the statutes based on this scheme which remain in force have been repeatedly amended by enlarging the permissible objects, so that although these permissible objects now embrace all the more usual forms of business activity, yet when some novel enterprise is being launched great difficulty may be experienced in deciding whether or not it falls within the statute.

Where a statute enumerated a number of different objects for which corporations might be formed, it was held in Texas that one corporation could not be formed for two of such objects or purposes;⁵ and *a fortiori* this result is reached where the enumerated objects are separated in the statute by the disjunctive "or."⁶ On the other hand, the objects of a corporation may be more circumscribed than any one of the classes named

¹ *Ancient City Sportsman's Club v. Miller*, 7 Lans. (N. Y.), 412.

² *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593; 54 N. E. 407.

³ *Miller v. Todd* (Tex.), 67 S. W. 483; 95 Tex. 404.

⁴ *Central Trust Co. v. Warren*, 121 Fed. 323; 58 C. C. A. 289. As to the meaning of the word "industrial" as applied to corporations, see further, *Wells, Fargo & Co. v. Northern Pac. Ry. Co.*, 23 Fed. 469,

474-475 (case of an express company).

⁵ *Ramsey v. Tod*, 95 Tex. 614; 69 S. W. 133; 93 Am. St. Rep. 875.

Cf. *Dancy v. Clark*, 24 App. D. C. 487.

But see *Finnegan v. Noerenberg*, 52 Minn. 239, 245; 53 N. W. 1150; 38 Am. St. Rep. 552; *Louisiana Navigation, etc. Co. v. Doullut*, 114 La. 906; 38 So. 613.

⁶ *Williams v. Citizens' Enterprise Co.*, 25 Ind. App. 351; 57 N. E. 581;

in the statute. For instance, if one of the objects for which companies may be incorporated is manufacturing, a corporation may be formed for engaging in one particular kind of manufacturing.¹ Moreover, it is permissible to combine two or more objects all of which are within one of the classes designated in the statute, such as the mining of both gold, silver, and lead, where mining in general is one of the objects mentioned in the statute for which corporations may be formed.²

§ 49-§ 63. *Under Statutes permitting Incorporation for any Lawful Purpose.*

§ 49. **In general.** — The statutes now in force in most parts of America as well as in Great Britain provide for the formation of corporations for any lawful purpose or objects.³ From these sweeping terms, express exception is usually made of banking, insurance, railroad purposes, etc.; but these exceptions are generally few and of a kind that does not call for extended consideration here.⁴ Some statutes, after mentioning a number of specific purposes for which corporations may be formed, add "or other lawful business," or, "other lawful purpose" or the like. It has been held that such general expressions cannot be confined in their operations to objects *ejusdem generis* with those

West Manayunk, etc. Co. v. New Gas Light Co., 21 Pa. Co. Ct. Rep. 393; *Consumers' Gas Trust Co. v. Quinby*, 137 Fed. 882; 70 C. C. A. 220; *People ex rel. Belknap v. Beach*, 19 Hun (N. Y.), 259, 260 (semble).

Cf. *Bayou Cook, etc. Co. v. Doullut*, 35 So. 729; 111 La. 517.

¹ Cf. *Roofing Contractors' Ass'n*, 200 Pa. St. 111; 49 Atl. 894.

² *People ex rel. Belknap v. Beach*, 19 Hun (N. Y.), 259.

³ As to incorporation for an unlawful purpose, or purpose contrary to public policy, see *infra*, § 62 and Chap. V.

⁴ Cf. *Dancy v. Clark*, 24 App. D. C. 487, 505-506 (where an incorporation paper which, after mentioning as one of the objects "to perform

contracts for maintaining and operating railways," provided that the company should "not operate any railroad, engage in the business of a railroad, or do anything in the premises prohibited to corporations of this character," was held not proper to be recorded under a statute prohibiting the formation of corporations for the operation of railroads); *State v. Debenture Guarantee, etc. Co.*, 26 So. 600 (formation of corporation to deal in debentures not permissible under statute providing for incorporation for any lawful purpose provided that no corporation should engage in "stock-jobbing"), affirmed as to federal questions in *New Orleans Debenture, etc. Co. v. Louisiana*, 180 U. S. 320; 21 Sup. Ct. 378.

specifically mentioned.¹ Moreover, where the statute authorizes incorporation "for the purpose of engaging in any lawful enterprise, business, pursuit or occupation," the words cannot be restricted to schemes for making money, but authorize incorporation for the purpose of aiding a certain educational institution by guaranteeing its bonds.²

§ 50. **Whether more than one Object may be specified.** — Where the statute authorizes the organization of companies for any lawful *purpose, business*, or the like, in the singular, doubt has been entertained whether a corporation may be formed for two or more distinct objects, or whether there must not be some one main purpose to which everything else is ancillary.³ To guard against all question of this sort, some statutes use a plural as well as the singular noun — "for any lawful purpose or purposes."⁴ But the doubt is probably unfounded.⁵ Thus, the British law provides that "any seven or more persons associated for any lawful *purpose*" may, by subscribing, etc., form an incorporated company.⁶ Yet neither the English lawyers nor their courts have ever denied that a corporation might lawfully be organized under this statute for two or more disconnected pur-

¹ *Brown v. Corbin*, 40 Minn. 508; 42 N. W. 481; *Glen v. Breard*, 35 La. Ann. 875; *State ex rel. Walker v. Corkins*, 123 Mo. 56; 27 S. W. 363; *National Bank v. Texas Investment Co.*, 74 Tex. 421; 12 S. W. 101 (distinguishing *Texas, etc. Navigation Co. v. County of Galveston*, 45 Tex. 272); *Vokes v. Eaton*, 85 S. W. 174; 27 Ky. Law Rep. 358; *Lindsay, etc. Co. v. Mullen*, 176 U. S. 126, 138-139 (headnote inadequate); 20 Sup. Ct. 325.

But see contra: *State ex rel. Lederer v. International Investment Co.*, 88 Wisc. 512; 60 N. W. 796; 43 Am. St. Rep. 920 (with which compare *Wisconsin Telephone Co. v. City of Oshkosh*, 62 Wisc. 32, 38; 21 N. W. 828.)

Cf. *Banker's Mut. Casualty Co. v. First Nat. Bank* (Iowa), 108 N. W. 1046 (holding that a statute providing for incorporation of companies for insurance against damage by fire "or other casualty" should not be

limited by the *ejusdem generis* rule and that a corporation could accordingly be formed to insure against burglary); *St. Louis Colonization Ass'n v. Hennessy*, 11 Mo. App. 555, 559 (headnote inadequate).

² *Marwell v. Akin*, 89 Fed. 178.

³ See *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 290; 8 L. R. A. 497; 22 N. E. 798; 17 Am. St. Rep. 319 (stated and criticised infra, § 52); *Ramsey v. Tod*, 95 Tex. 614; 69 S. W. 133; 93 Am. St. Rep. 875; *Williams v. Citizens' Enterprise Co.*, 25 Ind. App. 351, 355; 57 N. E. 581; *Dancy v. Clark*, 24 App. D. C. 487, 500-504 (a strong but, it is submitted, a questionable decision); *State v. Taylor*, 55 Ohio St. 61, 67-68; 44 N. E. 513.

⁴ New Jersey Laws, 1899, chap. 176.

⁵ Cf. *People ex rel. Belknap v. Beach*, 19 Hun (N. Y.), 259.

⁶ Companies Act, 1862, § 6.

poses. Thus, an English text-writer of authority declares: "There is no rule, for instance, that the principal or leading object must be stated, and that all the other objects must be conducive or auxiliary thereto. On the contrary, it is permissible to have any number of objects alternative, concurrent, or substitutional, provided they are legal and are specified. Thus, the objects clause may commence by declaring that the company is formed to carry on the business of a brewery company; but there is not the slightest objection in point of law to stating that another object is to carry on the business of a mining company."¹ To be sure, the British act directs that the memorandum of association or incorporation paper shall state the "*objects*" of the company;² but this use of a plural noun has never been thought to enlarge the singular term, "purpose," which is found in a preceding section of the same statute.³ In some of the United States the general rule of statutory construction has been laid down that the singular number shall include the plural unless a contrary intention clearly appear; and this rule of construction would remove all difficulty arising from the use of a singular instead of a plural noun.

§ 51. **Insertion of Subsidiary Objects or Powers.** — Under statutes allowing incorporation for any lawful purposes, it seems abundantly clear on principle that the incorporation paper may in addition to the company's main object mention as subsidiary objects the exercise of any powers that the promoters may deem conducive thereto although not perhaps such as the law would have implied as incidental to the prime objects. This proposition is so thoroughly supported by the liberal policy of the law that one should be surprised to find it questioned. In England, no doubt ever appears to have been entertained. Thus, although

¹ Palmer's Company Law, 17. Cf. *Governments Stock Investment Co.* (1891), 1 Ch. 649, 655, where Chitty, J., said: "The legislature, no doubt, was aware that according to the way in which the Limited Liability Act has been worked, the framers of memoranda of association insert sometimes, under letters which exhaust the alphabet, what they are pleased to call the 'objects' of the company. You may get as to an

hotel company, 'The object of this company is to carry on the business of an hotel'; and you may go down from that in a manner which will surprise the uninitiated, and find out what the hotel company may, according to the ingenious framer of the memorandum of association, do — things which I think would astonish any ordinary hotel keeper."

² Companies Act, 1862, § 8 (3).

³ § 6.

the English courts will not readily imply the power to issue negotiable paper, express provisions making the issue thereof a subsidiary object of the company in question are frequent and undoubtedly efficacious. The English books are full of similar instances in which promoters have inserted in incorporation papers clauses mentioning this, that, or the other, as one of the company's objects, merely in order to remove any possible doubt as to whether the power would be implied as incidental to the main objects; and the American reports contain similar instances.¹ The validity of such provisions is fundamental in modern corporation law, and ought not to admit of question.

§ 52. *People v. Chicago Gas Trust Company*. — An Illinois case, decided in 1890,² which is somewhat confused and reactionary, yet deserves detailed examination, lest it should prove misleading upon this truly fundamental subject. A company was incorporated under an Illinois statute which provided for the formation of corporations "for any lawful purpose." Its incorporation paper, or, to use the name in vogue in Illinois, its articles of incorporation, provided that the object of the company should be to engage in the manufacture, sale, and distribution of illuminating gas, and, to "purchase and hold or sell the capital stock, or purchase or lease or operate the property, plant, good-will, rights and franchises, of any gas works, or gas company or companies." In fact, the corporation was organized to acquire the majority of the shares of the four competing gas companies which were then in operation in the city of Chicago; and did accordingly carry out that purpose. It never established any gas works of its own. Upon a proceeding in the nature of *quo warranto* to test the company's right to hold the controlling interest in the subsidiary corporations, the court held that the right did not exist. One ground relied upon by the court and broad enough to support the decision was that, the unlawful design having been entertained of creating a virtual monopoly, the company was not organized for a lawful purpose. If the opinion had rested here, no fault need have been found with the case; but various other propositions were advanced. In the

¹ See *People ex rel. Loy v. Mount Shasta Mfg. Co.*, 107 Cal. 256; 40 Pac. 391.

² *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497.

first place, it was said that the power to hold the shares could not be implied as incidental to the power to manufacture and sell illuminating gas; and upon this point the case is certainly in accord with the weight of authority.¹ As to the clause in the incorporation paper purporting expressly to confer the power, the court reasoned that if the clause were viewed as ancillary to the power to operate gas works, it would not be effective since the promoters could not by express stipulation augment the implied or incidental powers. If this *obiter dictum* were correct, it would indeed be laying the axe at the root of the tree; but as we have shown in the last paragraph it is believed to be opposed both to authority and to reason.² The legislature, by enabling the promoters to organize a corporation for any lawful purpose that they might mention in their incorporation paper indicated a liberal policy; and why should not the intention of the promoters that a certain power should be exercisable be carried out if possible? Why should they not have the right under a statute of this liberal sort to say what shall be deemed in their case incidental powers? It is submitted that if the power to hold shares in other companies might be made the principal object, or one of the principal objects, of the company, then only one who delights in unjust technicalities could think that the same power should not be exercisable if given as merely ancillary to some other object. The court, however, proceeded to decide that the holding of a controlling interest in the other gas companies could not be made the company's principal or only object because of the unlawful intention of creating a monopoly. With this latter position, as applied to the particular facts of the case, we have, as already stated, no disposition to quarrel. The court adverted to the fact, as specially indicative of monopoly, that the power sought to be conferred was to acquire and hold not certain shares of stock, but "*the capital stock*" — that is, all the shares.³

§ 53. **Objects must be consistent with Nature of a Corporation.** — Under any statute, however liberal, the objects of the company must be legal⁴ and must not be obnoxious to the gen-

¹ *Infra*, § 83.

² 130 Ill. 290-291.

³ *Cf. People ex rel. Loy v. Mount Shasta Mfg. Co.*, 107 Cal. 256; 40 Pac. 391.

⁴ See *infra*, § 62 and Chap. v.

eral spirit pervading the act or to accepted principles of corporation or company law. Thus, in any jurisdiction where the purchase by a corporation of its own shares is deemed foreign to the nature of a limited company, a clause in the incorporation paper purporting to confer a power to make such purchase is illegal and void.¹ The same thing would be true of an attempt to authorize the payment of dividends out of capital, the giving of a preference to shareholders over creditors in the distribution of assets in a winding-up, or any other transaction which is regarded as contrary to the spirit of the statute and to the statutory conception of a corporation.²

§ 54. **Sale of Entire Business as one of the Objects.** — The sale of a business or undertaking is a perfectly lawful object; and hence, according to English authorities, a clause in an incorporation paper mentioning the sale of the company's whole business or undertaking as one of its objects is entirely valid under a statute allowing incorporation for any lawful purpose.³ So, also, the incorporation paper may properly provide for a transfer of the company's business and undertaking in exchange for shares in another corporation,⁴ or other property. A sale or transfer of all the corporation's assets, in pursuance of such a provision, is to be deemed a transfer in the ordinary course of business, so that upon the consummation of the transaction, the company does not necessarily cease to be a going concern.⁵

§ 55. **American Cases.** — The American cases on the subjects treated in the last paragraph are neither numerous nor conclusive. In respect to corporations formed by special act, the law was well settled that no power of selling or leasing their whole property and business, or franchises, existed unless par-

¹ *Trevor v. Whitworth*, 12 App. Cas. 409, 436-437 (semble, per Lord Macnaghten).

² Cf. *infra*, § 122 and § 624.

³ *Cotton v. Imperial, etc. Corporation* (1892) 3 Ch. 454, 458 (head-note inadequate).

⁴ *Cotton v. Imperial, etc. Corporation* (1892), 3 Ch. 454, 458 (head-note inadequate); *Doughty v. Lomgunda Reefs* (1902), 2 Ch. 837 (where the incorporation paper was held to authorize a contract of sale, the terms of which could not be carried

out without a winding-up, but where [pp. 840-841] the judge doubted whether on principle, an incorporation paper should be permitted to state any but the "living objects" which the company is to carry out as a "living concern"). A power of sale or exchange such as is referred to in the text is not readily implied. *People v. Ballard*, 134 N. Y. 269; 32 N. E. 54; 17 L. R. A. 737. See also *infra*, § 78-§ 79.

⁵ *Foster v. Borax Co.* (1901), 1 Ch. 326.

ticularly conferred by statute. Especially, was this true with respect to public-service corporations such as railroads.¹ But manifestly, these cases have no application to companies which are incorporated under general laws authorizing incorporation for any lawful purpose. Surely, the English cases are right in holding that to build up a business for the purpose of selling it at a profit is a lawful object. In a case stated above at considerable length, the United States Supreme Court held in substance that the leasing, or taking a lease, of a railway was not a lawful object for incorporation under the Oregon general laws, which provided that companies might be incorporated for "any lawful business, pursuit or occupation."² But railroad corporations even when organized under general laws are very different from companies having no public duties to perform. A railway company enjoys the power of condemning private property; and sometimes provision is made for a judicial investigation into the fitness of the corporation to be entrusted with this delicate franchise, so that perhaps public policy might be thought to prohibit a complete transfer of its line into other hands by sale or lease. Moreover, even where general laws provide for the incorporation, construction, and operation of railways, the sale or lease of a completed road, involving, as it generally does, a transfer of control from small local capitalists to some great foreign corporation or syndicate, may be deemed contrary to the policy of the law. At all events, the case with respect to a railroad differs materially from that of mere industrial corporations with no public duties to perform. Consequently, while one should expect *Oregon Railway Company v. Oregonian Railway Company* to be followed in America, yet its doctrine ought not to be and probably would not be, extended or applied so as to prohibit the organization of an industrial corporation for the purpose of selling or otherwise disposing of its whole business and property or, in other words, its "undertaking."³ To build

¹ See, for example, *Kean v. Rys., etc. Co.*, 49 N. J. Eq. 217, 241; *Johnson*, 9 N. J. Eq. 401; *Thomas v. Railroad Co.*, 101 U. S. 71.

² *Oregon Ry. Co. v. Oregonian Ry. Co.*, 130 U. S. 1; 9 Sup. Ct. 409.

³ *Traer v. Lucas Prospecting Co.*, 99 N. W. 290; 124 Iowa, 107.

Cf. *Ellerman v. Chicago Junction* however, to be construed as embrac-

up a private business for the purpose of selling it advantageously is, for individuals, a very usual and perfectly lawful aim. Why should not the formation of a corporation for the same object be equally legitimate under any incorporation law providing for the organization of companies for any lawful purpose or business? Where the statutes restrict the right to incorporate to certain named classes of companies, it is, however, probably true that no corporation can be organized for the purpose of selling its business and undertaking: for, however numerous the specified objects for which such statutes permit incorporation, this is not one of them.¹

§ 56. **Acting as Agent or Attorney as one of Objects.** — To act as agent or attorney in fact for other persons is a lawful business, and therefore a corporation may be organized for that object.² The objection that a corporation can act only by agents, and therefore cannot be itself an agent, since *delegata potestas non potest delegari*, is wholly unsubstantial; for any person who employs a corporation as agent necessarily consents that it shall in the course of its agency act through sub-agents.³ And likewise the objection that a corporation cannot as agent execute deeds of real estate on the principal's behalf, since, being an impersonal entity, it cannot make an acknowledgment, is untenable; for the corporation can make the acknowledgment in the same way as if it were a principal, namely, by its officers. Consequently, a corporation may even be formed to act as agent or

ing powers to do those things which would deprive the corporation of its ability to carry out the objects for which it was formed, or discharge any duties which it might, under its charter, owe to the public, or which are contrary to the policy of the law"); *People ex rel. Barney v. Whalen*, 104 N. Y. Supp. 555 (provision for sale of entire property held to be in conflict with a statute expressly conferring a more limited power of the same general kind); *People ex rel. Barney v. Whalen*, 106 N. Y. Supp. 434 (similar decision to last case).

¹ See *infra*, § 78.

² *Killingsworth v. Portland Trust Co.*, 18 Oreg. 351; 23 Pac. 66; 7 L.

R. A. 638; 17 Am. St. Rep. 737; *State ex rel. Le Blanc & Railey v. Michel*, 36 So. 869; 113 La. 4.

Cf. *Morris v. Third Nat. Bank*, 142 Fed. 25; 73 C. C. A. 211 (where under peculiar circumstances a national bank was held to have implied power to act as representative of other persons); *Anderson v. First Nat. Bank*, 5 N. Dak. 451; 67 N. W. 821 (also relating to the powers of national banks as agents).

³ *Snow, Church & Co. v. Hall*, 19 N. Y. Misc. 655; 44 N. Y. Supp. 427 (a corporation formed to carry on a collection agency may employ attorneys at law to collect claims and charge their fees against its client).

broker in the purchase or sale of its own shares.¹ A corporation may be formed to carry on the business of acting as agents of other persons even though a statute provides that no corporation shall act as administrator or guardian, or fill "any other office of personal trust";² for the words last quoted refer to offices of personal trust *ejusdem generis* as those specially mentioned and not to mere private agencies.

§ 57. **Acting as Trustee.**—To act as trustee is a lawful object; and therefore under statutes providing for the formation of corporations for any lawful purpose, there is no reason why acting as trustee should not be mentioned in the object clause of an incorporation paper as an object of the proposed company, unless indeed the acting as trustee be contrary to the very nature of a corporation. Now, under the Statute of Uses the doctrine was established in early times that a corporation could not be a trustee or feoffee to uses; for how, it was said, can trust be reposed in a being which has no soul or conscience? The force of this reasoning has, of course, long since ceased to be felt;³ and ever since the growth of modern trusts, the courts have held that a corporation may act as trustee whenever so to do is a reasonable method of attaining the objects for which it was formed.⁴ Indeed, it would seem that to-day in America a corporation may be seised to a use under the Statute of Uses, and may accordingly convey land by a deed of bargain and sale.⁵ Even if the corporation which is appointed trustee by deed or will have no corporate power so to act, nevertheless equity will not permit the trust to fail but will compel the corporation or whoever holds

¹ *Borland's Trustee v. Steel Bros. & Co.* (1901), 1 Ch. 279, 293 (head-note inadequate).

² *State ex rel. Le Blanc & Railey v. Michel*, 36 So. 869; 113 La. 4.

³ Cf. Bacon on Uses, p. 57, where a less scholastic reason is assigned for the doctrine. "A corporation," says the author, "cannot be seised to an use . . . chiefly because of the letter of the Statute which in any clause when it speaketh of the feoffee resteth only upon the word person, but when it speaketh of *cestui que use*, it addeth person or body politic."

⁴ *Attorney-General v. Whorwood*, 1 Ves. Sr. 534, 536 (per Lord Hardwicke); *Re Howe*, 1 Paige (N. Y.) 214; *Vidal v. Girard's Ex'rs*, 2 How. 127, 187; *Stobart v. Forbes*, 13 Manitoba, 184; *De Camp v. Dobbins*, 29 N. J. Eq. 36, 39-40; *Phillips Academy v. King*, 12 Mass. 546; Lewin on Trusts, 11th ed., 30; Perry on Trusts, 5th ed., § 42.

Cf. *Greene v. Dennis*, 6 Conn. 292, 304.

⁵ Angell & Ames on Corps., 2d ed., 153-154.

But see *Greene v. Dennis*, 6 Conn. 292, 304 (semble).

the legal title to convey the trust property to the person whom the chancellor may appoint to execute the trust.¹ The conclusion necessarily follows that under the modern liberal laws, acting as trustee may be mentioned in an incorporation paper as an object for which the company is formed.² Sometimes general incorporation laws provide that trust companies cannot be incorporated under them; and where such statutes are in force there may be a question whether a company can be incorporated for the purpose of acting as trustee. In other cases it may be inadvisable to mention the acting as trustee as one of the objects of the corporation lest the company be subjected to burdensome statutory regulations applicable to trust companies.

§ 58. **Acting as Executor, Guardian, etc.** — Whether a corporation may be formed to act as executor or administrator or as guardian of an infant or committee of a lunatic, is a different question. It is settled that a corporation has no implied power to act in any of those capacities. For instance, where a statute provides that in case a will appoints no executor, administration shall be granted to the residuary legatee, a charitable or educational corporation which is named as residuary legatee cannot be appointed administrator.³ It would follow that such a corporation, although named as executor, would have no right to letters testamentary.⁴ It has even been held in Nebraska that an order of a probate court appointing a corporation administrator is void, and subject to collateral attack.⁵ The reason for this doctrine is that statutory provisions requiring executors and administrators to make oath to this, that, and the other, in the

¹ *Vidal v. Girard's Ex'rs*, 2 How. 127, 188.

Cf. *Jackson ex dem. Lynch v. Hartwell*, 8 Johns. (N. Y.) 422 (deed to corporation in trust held not to pass legal title when corporation has no power to execute the trust, with a query whether a court of equity would prevent the trust from failing for want of a trustee).

² *State ex rel. Higby v. Higby Co.* (Iowa), 106 N. W. 382.

³ *President, etc. of Georgetown College v. Browne*, 34 Md. 450, 455 (semble); *Thompson's Estate*, 33 Barb. (N. Y.) 334. Cf. *Re Kirk-*

patrick's Will, 22 N. J. Eq. 463 (holding that in such a case administration should be granted to one of the members of the corporation).

⁴ Cf. 1 Williams on Executors, 9th ed., 183, 184 (where early English authorities, pro and con, are referred to); 1 Woerner's Am. Law of Administration, § 233, p. 509 (where the author expresses the opinion that the modern trend of authorities in the United States is in favor of the capacity of corporations to act as executors).

⁵ *Continental Trust Co. v. Peterson* (Nebr.), 107 N. W. 786.

course of the administration show that natural persons alone are contemplated.¹ As *res integra* it might be doubted whether this reasoning is altogether conclusive. Nevertheless, wherever such reasoning has been accepted, it would necessarily seem to follow that a corporation cannot be formed, even though the statute authorize incorporation for any lawful object, for the purpose of acting as executor or administrator, and that any provision in an incorporation paper purporting to empower the company to act in either of those capacities would be ineffective.² According to this view, affirmative legislative sanction is necessary in order that a corporation may act as executor or administrator. This legislative sanction is, nowadays, not infrequently granted.³

§ 59. **Owning Shares in another Corporation.** — The formation of a corporation for the purpose of controlling another corporation by means of ownership of shares in the latter company is often highly desirable. Such a purpose is not in itself unlawful unless it be foreign to the nature of a corporation to become a member of another corporation. It would seem clear that this is not so, and that in the absence of some direct statutory prohibition, the ownership by one business company of shares in another business corporation, even though possibly *ultra vires*, is not illegal or against public policy. "There is no reason at common law, so far as I know," said Lord Cairns, "why one corporate body should not become a member of another corporate body."⁴ This is rendered abundantly clear by several groups of cases, in which corporations are allowed to

¹ A corporation, says Blackstone, "cannot be executor or administrator, or perform any personal duties; for it cannot take an oath for the due execution of the office." 1 Black. Comm. 477.

² Cf. *State ex rel. Higby v. Higby Co.* (Iowa), 106 N. W. 382.

³ E. g. *Minnesota Loan & Trust Co. v. Beebe* (Minn.), 41 N. W. 232; 40 Minn. 7; 2 L. R. A. 418 (corporations as guardians); *Deringer's Adm'r v. Deringer's Adm'r*, 5 Houst. (Del.) 416; 1 Am. St. Rep. 150 (validity of foreign appointment of corporation recognized, although cor-

poration not qualified under domestic law); *Crowley v. Sandhurst, etc. Co.*, 23 Vict. L. R. 661 (holding that a corporation which by act of Parliament is authorized to act as trustee may act as co-trustee with individuals, as to which point see also *infra*, § 76); *Louisville, etc. R. R. Co. v. Herndon's Adm'r* (Ky.), 104 S. W. 732 (holding that a corporation which is authorized by statute to act as administrator may be appointed public administrator).

⁴ *Barned's Banking Co.*, 3 Ch. 105, 113.

become members of other corporations without any express authority.¹ Since, therefore, the ownership by one corporation of shares in another corporation is not necessarily contrary to the policy of the law, it follows that under statutes which authorize the incorporation of companies for any lawful purposes, a corporation may legally be organized with the acquisition and ownership of shares in other corporations as one of its objects as expressed in its incorporation paper.² Indeed, the so-called "holding-companies," which have become not infrequent in these latter days, are based on this principle.

§ 60. *Ownership of Shares with ulterior Illegal Intent.* — Of course, in any particular case the ownership of shares of stock by a corporation may be unlawful because of some ulterior illegal intent,³ such as the creation of a monopoly, restraint of trade, or the practical consolidation of competing lines of railway in fraud of some prohibitory statute⁴ or in violation of what is deemed the public policy of the state.⁵ Indeed, some cases apparently hold that the acquisition by one company of shares of stock in another corporation for the purpose of controlling the latter's business is *prima facie* at least contrary to public

¹ See *infra*, § 82.

² *Barned's Banking Co.*, 3 Ch. 105; *Dittman v. Distilling Co.*, 54 Atl. Rep. 570 (N. J. Ch.); *Market Street Ry. v. Hellman*, 109 Cal. 571, 589-590; 42 Pac. 225; *Traer v. Lucas Prospecting Co.*, 99 N. W. 290; 124 Iowa, 107; *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 696; 53 Atl. 842.

But see *People v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497 (stated and criticised *supra*, § 52); *Woodberry v. McClurg*, 29 So. 514; 78 Miss. 831 (decided under a Mississippi statute, known as the anti-trust law, expressly prohibiting corporations from owning stock of other companies); *Parsons v. Tacoma Smelting, etc. Co.*, 65 Pac. 765; 25 Wash. 492.

³ Cf. *Pearson v. Concord R. R. Corp.*, 62 N. H. 537; 13 Am. St. Rep. 590.

As to the impossibility of presum-

ing any such intent, see *National Salt Co. v. Ingraham*, 143 Fed. 805; 74 C. C. A. 479.

⁴ *Northern Securities Co. v. U. S.*, 193 U. S. 197; 24 Sup. Ct. 436; *People v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497 (stated and criticised, *supra*, § 52); *Dunbar v. American Tel., etc. Co.* (Ill.), 79 N. E. 423; 224 Ill. 9; *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869; *Southern Electric Securities Co. v. State* (Miss.), 44 So. 785; *Burrows v. Interborough Metropolitan Co.*, 156 Fed. 389 (where the general statute expressly authorized formation of corporations to acquire stock in other companies but also prohibited monopolies).

Cf. *Dittman v. Distilling Co.* (N. J.), 54 Atl. Rep. 570; *Trust Co. of Georgia v. State*, 35 S. E. 323; 109 Ga. 736; 48 L. R. A. 520.

⁵ *Elkins v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 5.

policy.¹ At all events, a scheme by which one corporation acquires a majority of the shares of another which at the same time acquires a majority of the shares of the former company is illegal; inasmuch as its effect would be to lodge permanent control of both companies in the men who happen at the time to be the directors, and to deprive the persons beneficially interested in the companies, namely, the other shareholders, of all power or control over their own property.² Where the ownership of shares in another company is not vitiated because of some illegal intent, the question whether the power exists is purely a question of construction of the incorporation paper.

§ 61. **Amalgamation with other Corporations.** — The statutes of Great Britain and of most of the United States contain express provisions authorizing a consolidation or amalgamation of corporations formed under them with other corporations of a similar nature. These provisions, at least in the United States, commonly provide for a consolidation in the technical sense in which that word is used in this country — that is to say, a coalescing or merger of the two with the result that a new corporation is formed which is distinct from either of the old ones and yet which in a certain sense is composed of both. In order to bring about a union of this sort, recourse must be had to express statutory authority; for without such authority not even the most express authorization in an incorporation paper would enable such a consolidation to be effected. On the other hand, where such statutory authority exists there is ordinarily no need of inserting in the incorporation paper any special clause sanctioning its exercise. But sometimes it is desirable to accomplish substantially the same end in a somewhat different way from that provided by the statute; and in such cases a clause may be inserted in the incorporation paper authorizing a consolidation or amalgamation, and such a clause is valid.³ The term amalgamation is difficult to define⁴ although it is of very frequent use especially in England. Sometimes, the provision simply authorizes a sale of the company's assets, business, and under-

¹ *Pearson v. Concord R. R. Co.*, 62 N. H. 537; 13 Am. St. Rep. 590; 64 N. J. Eq. 673; 53 Atl. 842.
Anglo-American Land, etc. Co. v. Lombard, 132 Fed. 721, 736-737; *Peacock* (1894), 1 Q. B. 622.
Dunbar v. American Tel., etc. Co., 79 N. E. 423; 224 Ill. 9.
² *Robotham v. Prudential Ins. Co.*,
³ *New Zealand Gold, etc. Co. v.*
⁴ Cf. *South African Supply, etc. Co.* (1904), 2 Ch. 268.

taking in exchange for shares in the purchasing company, which provision is quite valid.¹ No provision for such a sale or exchange or for an amalgamation will be construed to authorize an arrangement whereby the shares in the purchasing company which constitute the consideration for the transfer are to be distributed among those who are shareholders in the vendor company, and who upon the consummation of the scheme are to become members of the purchasing company whether they will or not;² although it seems to be conceded that if express authority for such an arrangement be embodied in the incorporation paper, it will be efficacious.³

§ 62. **Unlawful Objects** — *How Illegality determined.* — The determination of the question what is a lawful object does not, in general, depend at all on matters of corporation law. To lie, to steal, to kill are unlawful objects but their illegality does not depend on questions pertinent in a treatise on corporation law. The matter of incorporation for illegal purposes is, moreover, the subject of detailed consideration below.⁴ Suffice it here to say that the illegality may appear from other parts of the incorporation paper than the object clause. For instance, if the proposed name of the company involves a false representation, the company is not formed for a lawful purpose, however innocent the objects as specified in the object clause may be.⁵ The question whether the purpose of incorporation is lawful is ordinarily a question of state rather than of federal law.⁶

§ 63. **Incorporation for a Purpose provided for by a different Statute.** — Where one statute authorizes incorporation for any lawful purpose and another statute provides for the incorporation of certain kinds of corporations — such as railway, telegraph, telephone, or gas companies — it would seem that no company can be incorporated under the more general statute for purposes which are covered by the other statute.⁷ The legis-

¹ Supra, § 54-§ 55.

² *Ex parte Bagshaw*, 4 Eq. 341.

³ *Ex parte Bagshaw*, 4 Eq. 341, 348.

⁴ Infra, Chapter V.

⁵ *Rez v. Registrar Joint Stock Companies* (1904), 2 Ir. 634, 640.

⁶ *New Orleans Debenture, etc. Co. v. Louisiana*, 180 U. S. 320 (head-

note inadequate); 21 Sup. Ct. 378.

⁷ *Richards v. Dover*, 61 N. J. Law 400 (headnote inadequate), 39 Atl. 705. Cf. *Montclair Military Academy v. State Board of Assessors*, 65 N. J. Law 516; 47 Atl. 558; *Domeestic Telegraph Co. v. Newark*, 49 N. J. Law 344, 348; 8 Atl. 128.

lature is taken to have intended that, notwithstanding the general language of the former statute, no corporation should be formed for the purposes mentioned in the other statute without subjecting itself to the provisions of the last mentioned act. In any such case, the courts will if possible refer the attempted incorporation to the statute under which the company might have been organized rather than to that under which the corporation purported to be acting.¹

§ 64-§ 102. *WHAT POWERS IMPLIED WITHOUT EXPRESS MENTION IN OBJECT CLAUSE.*

§ 64. *In general.* — In drawing up the object clause of an incorporation paper, much may safely be left to implication. The old list of implied powers given by Blackstone and other early writers — the power to sue and be sued, to have perpetual succession, to make and use a common seal, etc., — is far too limited. Moreover, such so-called implied powers are usually expressly conferred by the general enabling act upon all corporations organized under it. There are many other powers, not enumerated in the text-books on the subject, and indeed so many and various as almost to defy enumeration, which are incidental to almost every modern corporation — certainly to every corporation framed on the joint-stock plan. Such powers need not be expressly mentioned in the incorporation paper in specifying the objects of the company.²

§ 65. *Caution as to Reliance upon Implications of Law.* — But although much may safely be left to implication, a few pregnant phrases carrying a world of meaning, yet the part of wisdom is to rely comparatively little on important powers being read into the incorporation paper by construction or implication. A learned and experienced English lawyer and text-writer has

¹ *Minneapolis, etc. Suburban Ry. Co.* (Minn.), 112 N. W. 13; *International Boom Co. v. Rainy Lake River Boom Co.*, 97 Minn. 513; 107 N. W. 735.

But cf. *David Bradley Mfg. Co. v. Chicago, etc. Traction Co.* (Ill.), 82 N. E. 210 (where the court said that where a corporation is organized

under a law for incorporation of commercial steam railroads, the word "street" should be disregarded in the incorporation paper, which set forth as the object of the company the construction of a street railway).

² *Kingsbury Collieries and Moore's Contract* (1907), 2 Ch. 259.

said on this subject: "A very concise statement of objects may, by implication, as the lawyer is aware, cover a great deal, but a memorandum of association is a popular document intended not merely for lawyers, but for the guidance of shareholders, directors, and of the general public, and, accordingly, it is not expedient to rely too much on implication. Experience shows that it is better to be explicit, and thus to preclude as far as practicable the doubts and difficulties which inevitably arise on the construction of a very concise statement of objects. Hence the somewhat elaborate statements of objects now so commonly found. These clauses may err by excess of detail; but over-elaboration is better than over-conciseness. Nothing is more irritating to those who have to manage a company than to find that the powers of the company are fettered or questioned, and its business impeded or prejudiced simply because the framer of the memorandum of association has framed it without sufficient foresight or judgment, and has, contrary to the fact, assumed that the ordinary business man is familiar with the legal and somewhat conflicting decisions as to the powers which may be implied by a concise statement of objects."¹

§ 66. **Caution as to express Mention of Powers that might be implied — Maxim of Expressio Unius.** — One danger lurks in over-elaboration and the statement of unnecessary details: that is, that the express mention of certain powers which would ordinarily be implied should be held an inferential exclusion of all other similar powers that would likewise ordinarily be implied. *Expressio unius exclusio alterius.*² Thus, an express power to borrow up to a certain amount would probably operate as an implied prohibition of borrowing to a greater amount,³ although, had nothing been said on the subject, the corporation would have possessed an unlimited power of borrowing. This danger may be averted by an express provision that the mention among the company's objects of certain powers shall not be deemed to exclude by inference the exercise of any powers

¹ Palmer's Company Law, 3d ed., 16. *unius* is "not applicable to the construction of charters"); *Kingsbury*

² But see *Edgewood Borough v. Collieries and Moore's Contract* Scott, 29 Pa. Super. Ct. 156 (where (1907), 2 Ch. 259, 267-268.

a somewhat misleading headnote ³ *Infra*, § 69.
states that the maxim *expressio*

that might have been implied if no such express mention had been made.

§ 67. **Necessity for Draftsman to consider what Objects may be implied — Scope of Treatment.** — In order to determine what objects or powers must be expressly mentioned in preparing an incorporation paper, and what need not,¹ it is necessary to consider somewhat in detail what powers and objects may be implied. This consideration will not be permitted, however, to extend to a thoroughly exhaustive examination of the subject of the implied or incidental powers of corporations, but will be confined to such points as may be useful to draftsmen of incorporation papers.

§ 68. **General Rules as to Implied Powers.** — The general rules with reference to implied powers are well established. First, all powers not affirmatively granted, either expressly or impliedly, are denied. A corporation has such powers, and such only, as are conferred upon it by the act of incorporation or its incorporation paper; all powers not either expressly or impliedly given are impliedly prohibited.² Secondly, a corporation may exercise all powers that are fairly incidental, or reasonably adapted, to the attainment of its expressed objects;³ and even a statute which provides that no corporation shall exercise any powers except such as are "necessary" to the exercise of the powers, or attainment of the objects, set forth in the incorporation paper does not alter this rule.⁴ It is in the application of the rule that doubts and difficulties are encountered; for the application of the rule involves "either a question of fact or at least a mixed question of law and fact," so that former adjudicated cases often furnish an unsatisfactory guide.⁵ The rule itself is settled beyond peradventure both in England and America. But the uncertainties of its application give rise, as already stated, to the desirability of mentioning expressly in the incorporation paper all powers that the company may desire to exercise, even though they might be thought implied or incidental to the attainment of its other objects.

¹ For an excellent and concise summary, see Palmer's *Company Law*, 3d ed., pp. 46, 47.

² See *supra*, § 46.

³ *Newport News Shipbuilding, etc. Co. v. Jones* (Va.), 54 S. E. 314.

⁴ *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 241-243; 23 Atl. 287.

⁵ *Attorney-General v. Mersey Ry. Co.* (1907), A. C. 415, 416, per Lord Loreburn.

§ 69-§ 74. *Power to Borrow.*

§ 69. **In general.** — Take for instance the power to borrow money.¹ It is well settled both in England and America that a corporation, having power, as of course it has as incidental to its very existence, to purchase any property or rights that may reasonably be deemed proper for its business, may purchase the same on credit; and in like manner may order work and labor to be done for it on credit.² In America, it may accomplish the same result by borrowing money to expend for its purposes;³ but in England this is indisputably true only in the case of trading companies, other corporations having perhaps no such power.⁴ The validity of a loan, wherever borrowing is *intra vires*, cannot be impeached because of an intention on the company's part, unknown to the creditor, to misapply the moneys and divert them to some *ultra vires* object.⁵ Consequently, there is in the United States no necessity to express in an incorporation paper the power of borrowing money as one of the company's objects. Moreover, any provision that may be inserted on the subject must either be regarded as surplusage, put in out of abundant caution, or else as restrictive in character. The latter alternative has received judicial approval.⁶ Thus,

¹ In *Southern Brazilian, etc. Ry. Co.* (1905), 2 Ch. 78, 84, it was said that the power to borrow is not properly an "object," and therefore need not be mentioned in the incorporation paper.

² *Bagnalstown & Wexford Ry. Co.*, Ir. Rep. 4 Eq. 505; *Cork and Youghal Ry. Co.*, 4 Ch. 748, 757 (semble).

³ *Watts's Appeal*, 78 Pa. St. 370; *Booth v. Robinson*, 55 Md. 419, 436; *Fidelity Trust Co. v. Louisville Gas Co.*, 81 S.W. 927; 26 Ky. L. Rep., 401; *Rockwell v. Elkhorn Bank*, 13 Wisc. 653; *Wyman v. Wallace*, 201 U. S. 230; 26 Sup. Ct. 495 (as to powers of national banks); *Bohn v. Boone Bldg. & Loan Ass'n* (Iowa), 112 N. W. 199 (a building society); *Heironimus v. Sweeny*, 83 Md. 146; 34 Atl. 823; 55 Am. St. Rep. 333; 33 L. R. A. 99; *Mead v. Keeler*, 24

Barb. (N. Y.) 20; *Fifth Ward Sav. Bank v. First Nat. Bank*, 48 N. J. Law 513; 7 Atl. 318 (a savings bank); *Partridge v. Badger*, 25 Barb. (N. Y.) 146; *Burr v. McDonald*, 3 Gratt. (Va.) 215; *Thompson v. Lambert*, 44 Iowa 239; *Wright v. Hughes*, 119 Ind. 324; 21 N. E. 907; 12 Am. St. Rep. 412; *Ward v. Johnson*, 95 Ill. 215; *Curtiss v. Leavitt*, 15 N. Y. 1; *Eastman v. Parkinson* (Wisc.), 113 N. W. 649.

But see *Bacon v. Mississippi Ins. Co.* (1856), 31 Miss. 116 (insurance company no power to borrow to pay liabilities).

⁴ 1 Lindley on Companies, 6th ed., 284, et seq.

⁵ See *infra*, § 1061.

⁶ In addition to cases cited below, see *Commonwealth v. Smith*, 10 Allen (Mass.), 448; 87 Am. Dec. 672.

where a special act of incorporation provided that the company should have power to borrow on mortgage to an amount not exceeding one third of the company's paid-up capital, any other borrowing was held to be *ultra vires*.¹ Indeed, express authority to a railway company to borrow on mortgage has been declared to be an implied prohibition of borrowing without security.² On the other hand, a clause in an incorporation paper purporting to empower the company "to issue bonds secured by mortgage or mortgages upon the property and franchises of said corporation, and to sell the same for the purpose of raising money with which to erect machinery" has been held not to be an implied prohibition of borrowing money on mortgage otherwise than by the issue of bonds and for a purpose other than the erection of machinery.³ This last cited case evinces what is submitted to be the proper attitude towards such questions.

§ 70. **Evasion of a Prohibition of Borrowing.** — Even where a corporation is expressly prohibited from borrowing, it may often accomplish virtually the same result by an outright sale of its property coupled with an agreement for a lease back to the company for a period of years at a rental equal in the aggregate to the purchase price and interest thereon, the title at the end of the term to revert to the company.⁴ Moreover, even where a loan is effected in violation of a prohibition, valuable rights may be acquired by the lender either upon the express contract or *quasi ex contractu*.⁵

§ 71. **Power to Mortgage.** — The power to borrow, wherever it exists, or to create an indebtedness, carries with it the power to secure the indebtedness by mortgage of some or all of the company's property.⁶ The only qualification upon this

¹ *Landowners', etc. Drainage Co. v. Ashford*, 16 Ch. D. 411, 436-437 (headnote inadequate); *Wenlock v. River Dee Co.*, 10 App. Cas. 354.

² *Chambers v. Manchester, etc. Ry. Co.*, 5 B. & S. 588. Cf. *Cape Sable Company's Case*, 3 Bland Ch. (Md.), 606. A power to mortgage includes power to borrow on mortgage bonds. *Gloninger v. Pittsburgh, etc. R. R. Co.*, 139 Pa. St. 13.

³ *Brown v. Citizens' Ice, etc. Co.* (N. J.), 66 Atl. 181.

Cf. *Thatcher v. Consumers' Gas & Fuel Co.* (N. J.), 66 Atl. 934 (where a statute purporting to empower corporations to increase their bonded indebtedness was held not to restrict by implication such corporations as already enjoyed a more extended power of issuing bonds than was allowed in the statute).

⁴ *Yorkshire Ry. Wagon Co. v. Maclure*, 21 Ch. D. 309.

⁵ Cf. *infra*, § 118.

⁶ *Watts's Appeal*, 78 Pa. St. 370; *Hopson v. Aetna Axle, etc. Co.*, 50

statement is in the case of railways and other public service corporations which, having no right to disable themselves from performing their public duties by alienating their road-bed or other necessary property, cannot lawfully create incumbrances upon the same which in case of foreclosure may result in alienation.¹ Even a railway company, however, has implied power to mortgage its surplus lands.² A corporation that has power to mortgage its property may execute a mortgage to secure future advances.³ The extent to which express provisions conferring a power to borrow on mortgage can be construed as prohibiting any other or further mortgaging has been considered in a former paragraph in connection with the power to borrow. An express power to execute mortgages to secure the repayment of borrowed money does not by implication exclude the power to create mortgages to secure debts contracted otherwise than for money lent.⁴ Where the directors of a company have power to mortgage but are prohibited from issuing bills of exchange, a mortgage securing a bill of exchange representing an antecedent debt will be enforceable.⁵

§ 72. *Power to mortgage uncalled Capital.* — While the power of a company to mortgage all its property and rights is in general incident to the power to borrow, an exception has been thought to exist in the case of one very peculiar right — the right to call up unpaid capital. In a comparatively early English case, the power of a corporation to create a charge upon future calls was denied;⁶ and while subsequent cases clearly hold that such a charge is legal if authorized by the company's memorandum

Conn. 597; *Booth v. Robinson*, 55 Md. 419, 436; *Patent File Co.*, 6

acquired property, see *infra*, § 1853-§ 1858.

Ch. 83; *Bickford v. Grand Junction Ry. Co.*, 1 Can. Sup. Ct. Rep. 696, 729-732; *Susquehanna Bridge, etc.*

¹ See Short on Railway Bonds and Mortgages, §142.

Co. v. General Ins. Co., 3 Md. 305; 56 Am. Dec. 740; *Bell & Coggeshall*

² *Imperial Mercantile Credit Ass'n v. London, etc. Ry. Co.*, 15 W. R. 1187.

Co. v. Ky. Glass Works Co. (Ky.), 50 S. W. 2; 20 Ky. Law Rep. 1684;

³ *Jones v. Guaranty, etc. Co.*, 101 U. S. 622.

Thompson v. Lambert, 44 Iowa 239; *Wright v. Hughes*, 119 Ind. 324; 21

⁴ *Allen v. Montgomery R. R. Co.*, 11 Ala. 437, 454.

N. E. 907; 12 Am. St. Rep. 412; *Ward v. Johnson*, 95 Ill. 215; *East-*

⁵ *Scott v. Colburn*, 26 Beav. 276.

man v. Parkinson (Wisc.), 113 N. W. 649.

⁶ *Stanley's Case*, 33 L. J. Ch. 535. Cf. *Sankey Coal Co. (No. 2)*, 10

As to power to mortgage after-

Eq. 381; *Bank of South Australia v. Abrahams*, L. R. 6 P. C. 265.

of association,¹ yet no case has decided that the power exists in the absence of any express authority therefor in the company's constitution.² In the United States, the question has not often arisen.³ This is natural enough; for the practice of carrying on business with a portion of the issued capital unpaid is much rarer than in Great Britain. It has been held that no power exists to mortgage an unpaid subscription to the company's capital where a statute empowers the company to mortgage its franchises and certain named kinds of property, not, however, mentioning unpaid subscriptions.⁴ At all events, a call which has been already determined upon but which is still unpaid may be mortgaged to the same extent as any other debt due to the company.⁵

§ 73. **Power to issue Notes, Bonds, etc.** — Another concomitant of the power to borrow is the power to give the lender some written evidence of the debt, such, for instance, as a bond;⁶ and, on principle, this evidence may be put in the most convenient and available shape, that is, in the shape of a promissory note or other negotiable instrument.⁷ In England, however,

¹ *Newton v. Anglo-Australian, etc. Co.* (1895), A. C. 244.

Cf. *Phoenix Bessemer Co.*, 44 L. J. Ch. 683; *Tilbury Portland Cement Co.*, 62 L. J. Ch. 814.

² But see *Jackson v. Rainford Co.* (1896), 2 Ch. 340, where a trading company whose memorandum of association was silent on the subject of borrowing and whose articles of association recognized a power to borrow on bonds, debentures, "or in such other manner as the company may determine," was held to have power to charge uncalled capital.

Cf. *Coler v. Grainger County*, 74 Fed. 16; 20 C. C. A. 267; *Beal v. Dillon*, 5 Kans. App. 27; 47 Pac. 317; *Lionberger v. Broadway Savings Bank*, 10 Mo. App. 499; *Eppright v. Nickerson*, 78 Mo. 482; *Racine County Bank v. Ayers*, 12 Wisc. 512.

³ See, however, American cases cited in last note.

⁴ *Morris v. Cheney*, 51 Ill. 451.

⁵ *Sankey Coal Co.*, 9 Eq. 721;

Gibbs & West's Case, 10 Eq. 312; *Wells v. Rodgers*, 50 Mich. 294; 15 N. W. 462.

But see *King v. Marshall*, 33 Beav. 565; *Morris v. Cheney*, 51 Ill. 451.

⁶ *Smith v. Law*, 21 N. Y. 296, 298-299; *Commissioners of Craven v. Atlantic, etc. R. R. Co.*, 77 N. Car. 289; *Rockwell v. Elkhorn Bank*, 13 Wisc. 653; *Barnes v. Ontario Bank*, 19 N. Y. 152, 156 (headnote inadequate); *Commonwealth v. Smith*, 10 Allen (Mass.), 448; 87 Am. Dec. 672; *Curtiss v. Leavitt*, 15 N. Y. 1 (where the giving of certain forms of evidences of indebtedness was prohibited by statute).

⁷ *Fidelity Trust Co. v. Louisville Gas Co.*, 81 S. W. 927, 26 Ky. L. Rep. 401; *Davis v. West Saratoga Bldg. Union*, 32 Md. 285; *Union Bank v. Jacobs*, 6 Humph. (Tenn.) 515; *Mead v. Keeler*, 24 Barb. (N. Y.) 20; *Fifth Ward Sav. Bank v. First Nat. Bank*, 48 N. J. Law 513; 7 Atl. 318; *Ward v. Johnson*, 95 Ill. 215.

it is held that in general no corporation has the power to issue negotiable paper unless expressly so authorized by statute or by its memorandum of association; although to this rule an exception exists *ex necessitate rei*, in the case of companies engaged in trade.¹ But in America the reasoning of these decisions has been criticised, and the rule adopted that every corporation that has power to borrow, whether it be organized for trading purposes or not, has power to evidence the debt by its promissory note, bill of exchange, or other negotiable instrument. Accordingly, we are relieved from considering the numerous decisions in England and the British colonies upon the question whether certain corporations are entitled to emit negotiable paper or not. Where an express statute gives power to a railway company to borrow money for construction of its road and to secure the debt by mortgage of its property and franchises, it may issue mortgage bonds as security for an indebtedness antecedently incurred for that purpose.² Where a corporation has power to borrow by a sale of its bonds, it may borrow by pledge of the bonds.³

§ 74. **Power to issue Irredeemable Bonds or Debentures.** — The power to “borrow” on perpetual or irredeemable bonds or other securities cannot readily be implied. In England, it is held that perpetual debenture-stock⁴ cannot be issued without express authority in the company’s memorandum of association. Indeed, a clause in the memorandum of association expressly authorizing the company to *borrow* money by the issue of debentures or debenture-stock will not justify the issue of irredeemable debenture-stock; and hence the issue of such security is *ultra vires* even though expressly sanctioned by articles of association adopted and recorded contemporaneously with such a memorandum.⁵ The word “borrow” implies that the money borrowed is sooner or later to be repaid. In Penn-

Note, however, that authority to an agent to borrow money does not empower him to execute a negotiable instrument in the principal’s name for the amount borrowed; *Bangs v. Nat. Macaroni Co.*, 15 N. Y. App. Div. 522; 44 N. Y. Supp. 546. Cf. *Hatch v. Coddington*, 95 U. S. 48.

¹ 1 Lindley on Companies, 6th ed., 242, 243.

² *Duncomb v. New York, etc. R. R. Co.*, 84 N. Y. 190, 200.

³ *Farmers’ L. & T. Co. v. Toledo, etc. R. R. Co.*, 54 Fed. 759.

⁴ See *infra*, § 1687.

⁵ *Southern Brazilian, etc. Ry. Co.* (1905), 2 Ch. 78.

sylvania, on the other hand, it has been held that irredeemable bonds may be issued without express authority.¹

§ 75-§ 76. *Power to acquire and hold Property.*

§ 75. *In general.* — The power to acquire and hold such real and personal property as may be advantageous for the company's business is sufficiently implied by the law without express mention either in the incorporation act or in the incorporation paper.² The amount of property which the company may acquire and hold is not at all limited by the nominal amount of its capital.³ The power extends to the acquisition and holding of property in the customary and most beneficial manner. Thus, a corporation, the period of whose existence is limited to a term of years, may acquire the fee-simple title to land.⁴ And a railway corporation having occasion to take a lease of real estate for its use may make the usual covenant to insure the premises, and if it fail to do so may be held responsible in case of fire for the amount of the loss.⁵ To be sure, the Statute of Wills,⁶ which first permitted testamentary disposition of legal title to real estate, by its express terms excepted devises to corporations so that such devises remained void as at common law.⁷ Although this exception was maintained in some of the early statutes of wills in the United States,⁸ it

¹ *Philadelphia, etc. R. R. Co.'s Appeal*, 4 Am. & Eng. R. R. Cases, 118 (Pa.).

Contra: *Taylor v. Philadelphia, etc. R. R. Co.*, 7 Fed. 386.

² *Central Ohio Natural Gas & Fuel Co. v. Capital, etc. Dairy Co.*, 60 Ohio St. 96; 53 N. E. 711; 64 L. R. A. 395 (manufacturing company held to have power to purchase entire business of an existing concern including a claim for damages for a tort); *Jamieson & McFarland v. Heim* (Wash.), 86 Pac. 165 (power to purchase commercial paper); *Brown v. Winnisimmet Co.*, 11 Allen (Mass.), 326 (ferry company authorized to acquire boats not needed for present use); *Mallett v. Simpson*, 94 N. Car. 37 (real estate).

As to the power to purchase

shares in other companies, see *infra*, § 81-§ 84.

³ *Infra*, § 577.

⁴ *Infra*, § 116.

⁵ *Jacksonville, etc. Ry. Co. v. Hooper*, 160 U. S. 514; 16 S. Ct. 379. As to the power of corporations to make the usual covenants in leases, see *Abby v. Billups*, 35 Miss. 618; 72 Am. Dec. 143 (covenant to repair and to rebuild in case of fire).

⁶ 34 Hen. VIII, c. 5.

⁷ Grant on Corporations, 112.

⁸ *McCartee v. Orphan Asylum Soc.*, 9 Cow. (N. Y.), 437 (holding that statutory power to "purchase" land does not confer power to take by devise); *Downing v. Marshall*, 23 N. Y. 366 (holding also that express statutory power to acquire land by "purchase or otherwise" puts the

has been omitted in the English Wills Act of 1837¹ and generally in the statutes of wills now in force in America,² so that corporations are now as competent to acquire land by devise as in any other way. The restriction upon devises to corporations wherever it exists is absolute and could hardly be defeated even by an express clause in the incorporation paper mentioning the acquisition of real estate by devise as one of the objects of the company. Indeed, the incapacity under the Statute of Wills was not so much that of the corporation as of the testator. Equitable interests in real estate have always been devisable³ without the aid of any statute, and therefore might always be devised to corporations;⁴ and so also personal property including chattels real might always be bequeathed to corporations.

§ 76. **Power to hold as Joint-tenant or in Common.** — It is generally supposed that at common law a corporation could not hold property in joint tenancy either with another corporation or with an individual.⁵ The essential characteristic of joint tenancy — namely the right of survivorship — cannot exist in the case of corporations. This rule has been abolished in England by express statute.⁶ Where no such statute exists, it would seem useless to express in an incorporation paper the holding of property as joint tenant as one of the objects of the company. The objection is inherent in the nature of a corporation, and not even under the most liberal incorporation laws can a company be incorporated for the purpose of doing what the law regards as an impossibility. There is no objection to a corporation

corporation on the same footing as natural persons in respect to capacity to take by devise). tions, § 178; 1 Morawetz on Priv. Corps., § 331.

As to the effect of such provisions upon devises of land in a state whose laws permit devises to corporations which are authorized to take, see *Law Guarantee Soc. v. Bank of England*, 24 Q. B. D. 406; Bacon Abr. Tit. "Joint-tenants and Tenants in Common," B; *DeWitt v. San Francisco*, 2 Cal. 289, 297 (semble); *Telfair v. Howe* (S. Car.), 3 Rich. Eq. 235; 55 Am. Dec. 637; *Starkweather v. Am. Bible Soc.*, 72 Ill. 50; *Thompson v. Swoope*, 24 Pa. St. 474. Freeman on Cotenancy and Partition, 2d ed., § 15 (questioning reason of rule).

¹ 1 Vict., c. 26.

² Stimson's Am. Stat. Law, § 2610.

³ 1 Sanders on Uses, 64.

⁴ Cf. Angell & Ames on Corpora-

⁵ "Bodies Corporate Joint Tenancy Act, 1899," 62 and 63 Vict., c. 20.

owning property as tenant in common.¹ Indeed, in America, it is not uncommon for a trust company to become a co-trustee with an individual,² and upon the death of the individual trustee the trust is generally supposed to devolve exclusively upon the corporation by survivorship.

§ 77-§ 79. *Power of Alienation.*

§ 77. **In general.** — Except in the case of public-service corporations³ the implied powers of alienation are ample without any supplement from express provisions.⁴ The only qualification to this statement, with respect to ordinary industrial corporations, is the case of a sale of the entire property, business, and undertaking of the company; and this case has been considered above at some length⁵ and will be further treated presently.⁶ The implied power to alienate extends to the most usual method of transfer. Thus, a corporation which holds negotiable paper may transfer the same by indorsement, and *a fortiori* may couple the sale with an express guarantee of payment.⁷ So, a corporation on assigning a mortgage may guarantee payment of the mortgage debt.⁸ Moreover, a corporation may lease its

¹ *De Witt v. San Francisco*, 2 Cal. 289; *Estell v. University of the South*, 12 Lea (Tenn.), 476; *Hackett v. Multnomah Ry. Co.*, 12 Oreg. 124; 6 Pac. 659; 53 Am. Rep. 327 (co-ownership of a ferry-franchise).

Cf. *Calvert v. Idaho Stage Co.*, 25 Oreg. 412; 36 Pac. 24.

² Cf. *Thompson v. Alexander* (1905), 1 Ch. 229 (holding that, in consequence of the "Bodies Corporate Joint Tenancy Act," a corporation may be appointed co-trustee with an individual); *Crowley v. Sandhurst, etc. Co.*, 23 Vict. L. R. 661 (holding that corporation may act as co-trustee with individuals in consequence merely of parliamentary authority to act as trustee and without any authority to act as joint-tenant). Cf. *Pennsylvania Co. for Ins. v. Bauerle*, 143 Ill. 459.

³ As to this, see Baldwin's Am. Railroad Law, 448 et seq.

⁴ *Kingsbury Collieries and Moore's Contract* (1907), 2 Ch. 259; *Binney's Case*, 2 Bland Ch. (Md.) 99.

⁵ *Supra*, § 54-§55.

⁶ *Infra*, § 78.

⁷ *People's Bank v. National Bank*, 101 U. S. 181; *Fidelity Trust Co. v. Louisville Gas Co.*, 81 S. W. 927; 26 Ky. L. Rep. 401; *Roosevelt v. Nashville, etc. Ry. Co.*, 128 Fed. 465 (head-note misleading); *Lloyd & Co. v. Matthews*, 119 Ill. App. 546 (indorsement of note of debtor for the purpose of enabling the latter to obtain money for payment of debt by negotiating or discounting the note), affirmed in 223 Ill. 477; 79 N. E. 172; 7 L. R. A., n. s., 376; *Broadway Nat. Bank v. Baker*, 176 Mass. 294; 57 N. E. 603.

Cf. *infra*, § 91.

⁸ *Blair v. Metropolitan Savings Bank* (Wash.), 67 Pac. 609; 27 Wash. 192.

surplus real estate and agree to pay the lessee at the end of the term the reasonable value of any buildings erected by him on the demised premises.¹

§ 78. **Sale of entire Property and Business.** — We have seen above that a sale of the entire business or undertaking and of all the property of a corporation which has no public duties to perform is a lawful purpose and may therefore properly be specified as one of the objects of a company incorporated under the liberal modern laws.² It would seem clear, however, that even under the modern liberal general incorporation laws a sale of the company's entire business (unless it be necessary to secure creditors) will be *ultra vires* unless the incorporation paper specifies such a sale as one of the objects of the company.³ This conclusion would seem to follow necessarily from the well established rule that companies incorporated by special acts have no implied power to transfer all their business and property except for the benefit of creditors. It has been held that a provision in an incorporation paper authorizing a sale of all the company's property will not justify a sale of all the company's property and "franchises" except the franchise to be a corporation.⁴ This limitation or qualification upon the general implied power of alienation is, however, very narrowly restricted, for a company has the implied power to sell out its works or plant for the purpose of acquiring others.⁵ Thus, a hotel company has the implied power to sell its hotel and purchase another.⁶

¹ *Hollywood v. First Parish in sumers' Gas Trust Co.*, 144 Fed. 640; *Brockton*, 192 Mass. 269, 277. 75 C. C. A. 442; *Anderson v. Shawnee Compress Co.* (Okl.), 87 Pac. 315

² *Supra*, § 54-§55.

³ *People v. Ballard*, 134 N. Y. 269; 32 N. E. 54; 17 L. R. A. 737; *Parsons v. Tacoma Smelting, etc. Co.* 65 Pac. 765; 25 Wash. 492 (lease instead of sale); *Hunt v. American Grocery Co.*, 81 Fed. 532; *Byrne v. Schuyler, etc. Mfg. Co.*, 65 Conn. 336; 31 Atl. 833; 28 L. R. A. 304. Cf. *Easun v. Buckeye Brewing Co.*, 51 Fed. 156.

⁴ *Coler v. Tacoma Ry., etc. Co.* (N. J.), 54 Atl. 413; 65 N. J. Eq. 347; 103 Am. St. Rep. 786 (note that this company was a public-service corporation).

⁵ In addition to cases cited below, see *Ritchie v. Vermillion Mining Co.*, 4 Ont. L. R. 588 (sale by mining company of its mine).

⁶ *Freeman v. Sea View Hotel Co.*, 57 N. J. Eq. 68; 40 Atl. 218.

Cf. *City of Indianapolis v. Con-*

So, a sale by a steamboat company of its only boat is *intra vires* although there be no express power of alienation.¹ Moreover, as already intimated, a corporation in failing circumstances has implied power to make a general assignment for the benefit of creditors,² or may sell all its property and business for the purpose of obtaining money to pay creditors.³

§ 79. **Sale of Business in exchange for Shares in purchasing Corporation.** — A clause authorizing a sale of the company's business and undertaking does not justify a transfer of the business in exchange for shares in the purchasing company, certainly not if the shares are to be issued not to the vendor corporation but to its several members.⁴ Such an arrangement is not a sale but is more in the nature of a consolidation or amalgamation.⁵ Even an express provision in an incorporation paper authorizing a sale of the company's business and undertaking in exchange for shares in another company will not sustain an agreement whereby the sale is to be made in exchange for partly paid shares in the vendee company with a stipulation that, in the event of a winding-up of the vendor company involving a distribution of the partly paid shares among the shareholders of the old company, any of the partly paid shares which should be distributable to a shareholder in the vendor company and which he should refuse to accept should be sold and applied in payment of debts of the vendor company, which by the terms of the contract the purchasing company was to assume.⁶

¹ *Leathers v. Janney*, 41 La. Ann. 1120; 6 So. 884; 6 L. R. A. 661.

² Cf. *Dupuy v. Terminal Co.*, 82 Md. 408. See also *infra*, § 1435, as to the powers of directors to authorize such an assignment.

³ *Phillips v. Providence Steam Engine Co.*, 21 R. I. 302. Cf. *infra*, § 1435.

⁴ *Dougan's Case*, 8 Ch. 540.

Cf. *Forrester v. Boston, etc. Mining Co.*, 21 Mont. 544, 560-564; 55 Pac. 229, 353; *Easun v. Buckeye Brewing Co.*, 56 Fed. 156; *Post v. Beacon, etc. Co.*, 84 Fed. 371; 28 C. C. A. 431 (where complainant shareholders had waived their right to object, by subscribing, though under protest, to their proportion of the shares of

the transferee company); *Taylor v. Burlington Cotton Mills*, 8 Hun (N. Y.) 1; *Elyton Land Co. v. Dowdell*, 113 Ala. 177; 20 So. 981; 59 Am. St. Rep. 105.

But see *Traer v. Lucas Prospecting Co.*, 99 N. W. 290; 124 Iowa 107; *Treadwell v. Salisbury Mfg. Co.*, 7 Gray (Mass.) 393, 404-406; 66 Am. Dec. 490; *Metcalf v. American School Furniture Co.*, 122 Fed. 115.

See also *supra*, § 61.

⁵ See *supra*, § 61.

⁶ *Manners v. St. Davids Gold, etc. Co.* (1904), 2 Ch. 593.

Cf. *Fuller v. White Feather Reward* (1906), 1 Ch. 823; *Bisgood v. Nile Valley Co.* (1906), 1 Ch. 747.

§ 80. **Power to abandon some of Company's Objects.** — Somewhat akin to the sale of a company's business is the abandonment of part of its objects for the purpose of devoting its funds exclusively to the remainder. This is generally permissible even without any explicit authorization in the incorporation paper.¹ Thus, where the objects of a company were stated to be the erection and maintenance of a brewery or breweries in Brighton and also the purchase of a brewery known as the North Street Brewery, the company may purchase a brewery known as the Brighton Brewery, although the consummation of such purchase will so deplete its funds as to preclude forever the purchase of the North Street Brewery.² On the other hand, a corporation which was formed under a special act for the purpose of constructing a railway from E. to P. and which was contemplating constructing only a small portion of that line — namely, from E. to L. — was enjoined, on a shareholder's bill, from applying its funds to the construction of that portion *only*, — that is, without any intention of completing the whole line.³ Moreover, a corporation cannot by contract bind itself not to exercise powers conferred upon it by its incorporation paper:⁴ to do so would limit and therefore alter the incorporation paper. If any such contract were clearly authorized by the incorporation paper itself, this objection would vanish; unless indeed such a provision should be held invalid under the principle that a clause in the incorporation paper authorizing the company to alter the instrument otherwise than as by statute allowed is void.⁵

§ 81-§ 84. *Power to become Member of another Corporation — to purchase Shares in another Company.*

§ 81. **In general.** — Another power which it is often desirable to exercise and about the existence of which question

¹ *Illinois Trust, etc. Co. v. Doud*, 105 Fed. 123, 128-129; 44 C. C. A. 389; 52 L. R. A. 481; *Thellusson v. Co.*, 2 Mac. & G. 146; *Bagshawe v. Viscount Valentia* (1906), 1 Ch. 480, affirmed in (1907), 2 Ch. 1. Cf. *Hodgson v. Powis*, 12 Beav. 392; *Graham v. Birkenhead, etc. Ry.*, 2 Mac. & G. 389.

² *Syers v. Brighton Brewery Co.*, 13 W. R. 220.

⁴ *Foster v. Borax Co.* (1901), 1 Ch. 326, 342 (semble); per Vaughan Williams, L. J.

³ *Cohen v. Wilkinson*, 1 Mac. & G. 481.

⁵ See *infra*, § 144.

is often raised is the power to acquire and hold shares in another corporation. Although the cases on this subject are far from harmonious, yet certain principles in regard to it are established by the substantial consensus of authority. We have seen above that this power may lawfully be enjoyed by a corporation, and hence may be made one of the expressed objects of incorporation under laws which allow companies to be incorporated for any lawful purposes. Whether the power exists, and to what extent, is entirely a question of construction of the incorporation paper.

§ 82. **When the Power may be implied.** — It is clear that in some cases the power may be implied without express language. In the first place, any corporation having power to lend money may accept shares in another corporation as collateral security,¹ and may in order to render the security as effective as possible become the registered holder of the shares either before² or after³ default on the borrower's part. Secondly, any corporation may accept shares in another company in discharge of a debt for which satisfaction can be obtained in no other way,⁴ and that too even though a statute expressly prohibits the pur-

¹ *Royal Bank of India*, 4 Ch. 252; *National Bank v. Case*, 99 U. S. 628, 633 (headnote inadequate); *Knowles v. Sandercock*, 107 Cal. 629, 643; 40 Pac. 1047 (semble); *Calumet Paper Co. v. Investment Co.*, 96 Iowa 147; 64 N. W. 782; 59 Am. St. Rep. 362; *Shoemaker v. Nat. Mechanics Bank*, 2 Abb. (U. S.) 416.

But there is a presumption against any intent on the part of the creditor corporation to make itself owner of the hypothecated shares: *Robinson v. Southern Nat. Bank*, 180 U. S. 295; 21 S. Ct. 383.

A bank on making a loan cannot accept shares as a bonus: *Nassau Bank v. Jones*, 95 N. Y. 115; 47 Am. Rep. 14.

² *Royal Bank of India*, 4 Ch. 252; *Calumet Paper Co. v. Stotts Investment Co.*, 96 Iowa 147; 64 N. W. 782; 59 Am. St. Rep. 362; *Victorian Mtge., etc. Bank v. Australian Financial, etc. Co.*, 19 Vict. L. R. 680.

Cf. *Franklin Co. v. Lewiston Institution*, 68 Me. 43; 28 Am. Rep. 9.

³ *National Bank v. Case*, 99 U. S. 628 (headnote inadequate).

⁴ *First Nat. Bank v. Nat. Exchange Bank*, 92 U. S. 122, 128 (semble); *Fidelity Insurance Co. v. German Savings Bank*, 127 Iowa 591; 103 N. W. 958; *Westminster Nat. Bank v. New England Electric Works*, 62 Atl. 971; 73 N. H. 465; 111 Am. St. Rep. 637; *Howe v. Boston Carpet Co.*, 16 Gray (Mass.) 493; *Lattimer v. Citizens' State Bank*, 102 Iowa 162; 71 N. W. 225; *First Nat. Bank of Charlotte v. Nat. Exchange Bank*, 39 Md. 600.

See also *Lands Allotment Co.* (1894), 1 Ch. 616; *Merchants' Nat. Bank v. Wehrmann*, 202 U. S. 295; 26 S. Ct. 613.

But see *First Nat. Bank v. Converse*, 200 U. S. 425; 26 S. Ct. 306.

chasing of stock in other corporations.¹ Moreover, in compromise of a disputed claim any corporation may pay a larger sum than would otherwise be exacted in consideration of the transfer to it of shares in another company, that arrangement being reasonably deemed the most advantageous settlement practicable.² Moreover, a corporation has incidental or implied power to insure its property with a mutual insurance company and thus become a member of the latter corporation.³ So, too, a corporation may perhaps have power to invest any surplus funds in some safe stocks, not for speculation, but merely for safe-keeping at a fair interest.⁴ For if a company has on hand surplus funds which for the time being are not needed in its business, is it bound to keep them on deposit at its bankers? May it not invest them temporarily in any safe securities? And if so, why not in shares of stock in other corporations? The only reason that can be assigned is that the transition to mere speculation is so easy.

§ 83. **When not implied.**—Except in the instances above enumerated, and in similar cases, the power to purchase shares in other companies is not readily implied. According to some courts, if their language is to be construed literally, the power does not exist unless conferred by express language;⁵ but this

¹ *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, 127 N. Y. 252; 27 N. E. 831; 24 Am. St. Rep. 448.

² *First Nat. Bank v. Nat. Exchange Bank*, 92 U. S. 122.

³ *St. Paul Trust Co. v. Wampach Mfg. Co.*, 50 Minn. 93; 52 N. W. 274.

⁴ Cf. *Joint Stock Discount Co. v. Brown*, 3 Eq. 139, 147-148; *Pearson v. Concord R. R. Co.*, 62 N. H. 537, 549; 13 Am. St. Rep. 590; *Burland v. Earle* (1902), A. C. 83, 95-97 (headnote inadequate); *Booth v. Robinson*, 55 Md. 419, 433; *Knowles v. Sandercock*, 107 Cal. 629, 643; 40 Pac. 1047; *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 687-689, 696; 53 Atl. 842; *Farmers' L. & T. Co. v. Perry*, 3 Sandf. Ch. (N. Y.) 339, 347-348; *Hodges v. New England Screw Co.*, 1 R. I. 312, 347.

But see *Shaw v. Nat. German-*

American Bank, 132 Fed. 658; 65 C. C. A. 620; affirmed short in 199 U. S. 603; 26 S. Ct. 750; *Schofield v. Goodrich Bros. Banking Co.*, 98 Fed. 271; 39 C. C. A. 76; *Bank of Commerce v. Hart*, 37 Nebr. 197; 55 N. W. 631; 40 Am. St. Rep. 479; 20 L. R. A. 780; *City of Goodland v. Bank of Darlington*, 74 Mo. App. 365 (semble). *People v. Chicago Gas Trust Co.*, 130 Ill. 268, 283-284; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497; *Concord First Nat. Bank v. Hawkins*, 174 U. S. 364; 19 Sup. Ct. 739.

⁵ *Knowles v. Sandercock*, 107 Cal. 629, 642; 40 Pac. 1047; *Holmes, etc. Mfg. Co. v. Holmes, etc. Metal Co.*, 127 N. Y. 252, 257; 27 N. E. 831; 24 Am. St. Rep. 448; *Commercial Fire Ins. Co. v. Board of Revenue Montgomery County*, 99 Ala. 1; 14 So. 490; 42 Am. St. Rep. 17; *Byrne*

view seems to lay undue stress on mere phraseology, and is opposed to the weight of authority. Thus, where one of a company's objects is to assist in forming other corporations, it may furnish assistance by purchasing shares of their capital.¹ Some cases seem to go to the extent of holding that any corporation (unless positively prohibited) may purchase shares in other companies having the same or connected objects;² but the weight of authority does not support this extreme position.³ Indeed, it has been held that power to purchase the business of other companies does not include power to accept a transfer of

v. Schuyler, etc. Mfg. Co., 65 Conn. 336; 31 Atl. 833; 28 L. R. A. 304; *Oelbermann v. New York, etc. Ry. Co.*, 77 Hun (N. Y.), 332; 29 N. Y. Supp. 545.

Authority to purchase "the capital stock" of certain corporations includes authority to purchase shares of stock in those companies. *People v. Chicago Gas Trust Co.*, 130 Ill. 268, 281 (semble); 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497.

¹ *Peruvian Ry. Co.*, 19 L. T. 803.

² *Booth v. Robinson*, 55 Md. 419; *Davis v. U. S. Electric, etc. Co.*, 77 Md. 35; 25 Atl. 982; *Joseph Bancroft & Sons Co. v. Bloede*, 106 Fed. 396; 45 C. C. A. 354; 52 L. R. A. 734; *Canada Life Ass. Co. v. Peel Gen. Mfg. Co.*, 26 Grant (Can.) 477.

Cf. *Hill v. Nisbet*, 100 Ind. 341; *Rochester, etc. R. R. Co.*, 110 N. Y. 119, 125; 17 N. E. 678.

As to purchasing the stock of a rival company to prevent competition, see *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 245, 246; 23 Atl. 287 and *supra*, § 60, and *infra*, § 302.

³ *California Bank v. Kennedy*, 167 U. S. 362; 17 Sup. Ct. 831; *De La Vergne, etc. Co. v. German Savings Institution*, 175 U. S. 40; 20 Sup. Ct. 20; *People v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497 (stated *supra*, § 52); *Pearson v. Concord R. R. Co.*, 62 N. H. 537; 13 Am. St. Rep. 590; *Central R. R.*

Co. v. Collins, 40 Ga. 582; *Easun v. Buckeye Brewing Co.*, 51 Fed. 156; *Lester v. Bemis Lumber Co.*, 74 S. W. 518; 71 Ark. 379; *Schofield v. Goodrich Bros. Banking Co.*, 98 Fed. 271; 39 C. C. A. 76; *Berry v. Yates*, 24 Barb. (N. Y.) 199, 210-213; *Milbank v. New York, etc. R. R. Co.*, 64 How. Pr. (N. Y.) 20; *Marble Co. v. Harvey*, 92 Tenn. 115; 20 S. W. 427; 18 L. R. A. 252; *New Orleans, etc. S. S. Co. v. Ocean Dry Dock Co.*, 28 La. Ann. 173; 26 Am. Rep. 90; *People ex rel. Maloney v. Pullman Car Co.*, 175 Ill. 125; 51 N. E. 664; 64 L. R. A. 366; *Newland Hotel Co. v. Lowe Furniture Co.*, 73 Mo. App. 135; *Ex parte Liquidators of British Nation Life Ass. Ass'n*, 8 Ch. D. 679, 704 ("The more or less similarity of the objects, or even the absolute identity of the objects, does not affect the principle").

Cf. *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 614-615.

See also *Hazlehurst v. Savannah, etc. R. R. Co.*, 43 Ga. 13, 57-58 (holding that a company organized to construct and operate a railway from M. to B. has no implied power to purchase shares in a railway having different termini); *Pauly v. Coronado Beach Co.*, 56 Fed. 428 (company formed to develop real estate no power to subscribe to shares in a manufacturing company); *Nassau Bank v. Jones*, 95 N. Y. 115; 47 Am. Rep. 14 (bank without power to subscribe to shares of railway company).

their shares.¹ On the other hand, a power to effect a "temporary or permanent" consolidation with any railway company justifies a purchase of all the shares of capital stock of a railway company.² Moreover, an express power to assist and participate in financial, commercial, and industrial operations and undertakings both singly and in connection with other persons, firms, companies, and corporations will authorize the purchase of shares in other companies.³ A bank has no power to aid in the incorporation of a correspondent by subscribing to its shares, although thereby it is hoped to benefit, indirectly, the subscribing bank by increasing the prosperity of the correspondent.⁴ A corporation which has power to borrow money has no implied power to subscribe to stock in a building and loan association for the purpose of obtaining a loan.⁵ Probably, all authorities agree that a corporation cannot engage in speculation in stocks, unless such speculation is one of the expressed objects for which the company is incorporated.⁶ From these various cases, it is apparent that a wise draftsman of an incorporation paper will often insert a clause mentioning the purchase of shares in other companies as one of the express objects of the company.

§ 84. **Effect of Clause specifying Acquisition of Shares in other Corporations as one of Objects.**— Even an express power to *purchase* shares in other companies must be confined to the purchase of shares from their former owners and will not authorize a subscription to new shares.⁷ If the corporation has

¹ *British Nation Life Ass. Ass'n*, 8 Ch. D. 679.

² *Tod v. Kentucky Union Ry. Co.*, 57 Fed. 47; 62 Fed. 335; 6 C. C. A. 47.

³ *Financial Corp.*, 28 W. R. 760.

⁴ *Joint Stock Discount Co. v. Brown*, 3 Eq. 139 (headnote inadequate), affirmed 8 Eq. 381.

Cf. *Pauly v. Coronado Beach Co.*, 56 Fed. 428.

⁵ *Mutual Savings, etc. Ass'n v. Meridan Agency Co.*, 24 Conn. 159.

⁶ *First Nat. Bank v. Nat. Exchange Bank*, 92 U. S. 122, 128 (semble); *California Bank v. Kennedy*, 167 U. S. 362; 17 Sup. Ct. 831;

Royal Bank of India's Case, 4 Ch. 252, 262 (semble); *Peshtigo Co. v. Great Western Tel. Co.*, 50 Ill. App. 624; *New Orleans, etc. S. S. Co. v. Ocean Dry Dock Co.*, 28 La. Ann. 173; 26 Am. Rep. 90; *Nebraska Shirt Co. v. Horton*, 93 N. W. 225; 3 Nebr. (Unof.) 888; *Sumner v. Marcy*, 3 Woodb. & M. 105; *Knowles v. Sandercock*, 107 Cal. 629; 40 Pac. 1047.

Cf. *Talmage v. Pell*, 7 N. Y. 328 (dealing by a bank in public stocks).

⁷ *Robotham v. Prudential Ins. Co.*, 64 N. J. Eq. 673, 685-687, 696; 53 Atl. 842; *Commercial Fire Ins. Co. v. Board of Revenue Montgomery*

power to subscribe for or in any way acquire shares in another company, it may subscribe for or purchase shares to which a liability is attached,¹ and consequently a shareholder cannot enjoin the company from subscribing for shares to be issued as fully paid upon payment of less than the par value.² A power to purchase shares or to "take stock" in other companies does not authorize a sale of the entire business to another corporation in exchange for shares in the latter company to be distributed *pro rata* among the shareholders of the former company.³ The power to acquire shares carries with it the power to exercise such rights of ownership as the right to vote.⁴ But it does not authorize such manipulation of the subsidiary company as will make it the dominant or holding company,⁵ nor does it authorize the acquisition of shares in pursuance of a scheme to create a monopoly.⁶

§ 85. **Power to Promote other Corporations.** — Somewhat akin to the power to purchase or subscribe for shares in other companies is the power to promote other corporations.⁷ The latter power may be implied from authority to engage in general monetary or financial enterprises,⁸ or perhaps from the expression of dealing in securities of other companies as one of the objects of the corporations;⁹ but the part of caution is to mention it expressly among the objects of the company, if its exercise

County, 99 Ala. 1; 14 So. 490; 42 Am. St. Rep. 17 (where the power was to invest in stocks).

But see *Rubino v. Pressed Steel Car Co.* (N. J.), 53 Atl. 1050.

¹ *Mason v. Motor Traction Co.* (1905), 1 Ch. 419; *Bisgood v. Nile Valley Co.* (1906), 1 Ch. 747, 758 (semble), per Kekewich, J.

² *Rubino v. Pressed Steel Car Co.* (N. J.), 53 Atl. 1050.

³ *Elyton Land Co. v. Dowdell*, 113 Ala. 177; 20 So. 981; 59 Am. St. Rep. 105. Cf. *supra*, § 79 and § 61.

⁴ *Infra*, § 1231.

⁵ *Robinson v. Holbrook*, 148 Fed. 107, stated *infra*, § 85.

⁶ *Bigelow v. Calumet, etc. Mining Co.*, 155 Fed. 869. And see *supra*, § 60, and *infra*, § 302.

⁷ *McAlester Mfg. Co. v. Florence Cotton, etc. Co.*, 128 Ala. 240; 30 So. 632 (as to becoming an original subscriber for shares in a new corporation).

⁸ *London Financial Ass'n v. Kelk*, 26 Ch. D. 107.

But see *Gause v. Commonwealth Trust Co.*, 106 N. Y. Supp. 288 (where a contract in the nature of a contract of underwriting was held *ultra vires* of a trust company).

⁹ *Rubino v. Pressed Steel Car Co.* (N. J.), 53 Atl. 1050. Cf. *supra*, § 84.

is thought desirable. A corporation formed for the purpose of manufacturing and of selling its products, and authorized to hold shares in other corporations, may, it has been held, organize subsidiary corporations to act as distributing agencies.¹ The opinion has been judicially expressed that a power to acquire shares in another corporation does not justify the use of the controlling interest in a subsidiary corporation for the purpose of largely increasing the capital of the subsidiary company by the issue of new shares to be offered to the shareholders of the controlling company in exchange for their shares in the latter company:² the effect of consummating the scheme would be to convert the subsidiary company into a holding company and to vest in it the control of the originally dominant company.

§ 86. **Power to become Member of Partnership.** — The power to become a member of a partnership is one which in general is foreign to the nature of a corporation; for the other partner would have the power to bind the corporation in the course of its business and thus virtually to supersede the machinery provided by law, consisting of directors, officers, and shareholders, for the management of the corporate business. Consequently, one may well doubt whether even under the most liberal incorporation laws, a clause specifying the formation of partnerships as one of the objects of the company would be legal. At any rate, without clear affirmative authority, no corporation has power to become a member of a partnership,³

¹ *Ditmann v. Distilling Co.*, 54 Atl. Rep. 570 (N. J. Ch.).

But cf. *Lagrone v. Timmerman*, 46 S. Car. 372, 410-411; 24 S. E. 290.

² *Robinson v. Holbrook*, 148 Fed. 107.

³ *Whittenton Mills v. Upton*, 10 Gray (Mass.) 582; 71 Am. Dec. 681; *Mallory v. Hanaur Oil Works*, 86 Tenn. 598; 8 S. W. 396; *Gunn v. Central R. R., etc. Co.*, 74 Ga. 509; *Marine Bank v. Ogden*, 29 Ill. 248; *Bishop v. American Preservers Co.*, 157 Ill. 284; 41 N. E. 765; 48 Am. St. Rep. 317; *Boyd v. American Carbon Black Co.*, 182 Pa. St. 206; 37 Atl. 937; *Burke v. Concord Railroad*, 61 N. H. 160; *New York, etc.*

Canal Co. v. Fulton Bank, 7 Wend. (N. Y.) 412 (semble); *Sabine Tram Co. v. Bancroft & Sons*, 16 Tex. Civ. App. 170; 40 S. W. 837; *Ex parte Liquidators of British Nation Life Ass. Ass'n*, 8 Ch. D. 679, 704; *People v. North River Sugar Refinery*, 121 N. Y. 582; 24 N. E. 834; 18 Am. St. Rep. 843; 9 L. R. A. 33.

Cf. *Charlton v. Newcastle, etc. Ry. Co.*, 5 Jur. N. S. 1096; *Butler v. American Toy Co.*, 46 Conn. 136 (where the corporation was authorized to form the partnership by the special act of incorporation); *Cleveland Paper Co. v. Courier Co.*, 67 Mich. 152; 34 N. W. 556 (where it was said that "a corporation may, in furtherance of the object of its

or to accept, even in satisfaction of a debt, shares in an unincorporated company, which in the eye of the law is a mere partnership.¹ These objections do not apply to a temporary partnership formed by the creditors of an insolvent debtor for the purpose of minimizing their loss by carrying on the debtor's business so as to realize as much as possible from his assets,² or to an agreement for pooling of earnings and expenses,³ or to a mere joint contract in a single transaction,⁴ or to a contract to give an employee a share in the company's profits in lieu of salary.⁵

§ 87-§ 90. *Power to contribute to Public Objects, recognize Moral Obligations, etc.*

§ 87. **In general.** — As all business corporations are formed for the acquisition of gain, they have no power, out of mere gen-

eration, contract with an individual, though the effect of the contract may be to impose upon the company the liability of a partner"); *Ontario Salt Co. v. Merchants Salt Co.*, 18 Grant Ch. (Up. Can.) 540 (agreement between manufacturing companies to sell exclusively to trustees of a syndicate held not *ultra vires*); *Allen v. Woonsocket Co.*, 11 R. I. 288; *Calvert v. Idaho Stage Co.*, 25 Oreg. 412; 36 Pac. 24 (holding that a corporation has implied power "to become a co-owner with an individual in a business or enterprise within the scope of its corporate powers"); *Hackett v. Multnomah Ry. Co.*, 12 Oreg. 124; 6 Pac. 659; 53 Am. Rep. 327 (joint ownership and operation of a ferry); *Breinig v. Sparrow* (Ind.), 80 N. E. 37 (as to liability to third persons); *Roedde v. News-Advertiser Pub. Co.*, 4 Brit. Columb. 7 (where only one of the judges held that a partnership was *ultra vires*).

A fortiori, a corporation has no power to enter into a partnership for carrying on a business that would be *ultra vires* if conducted by the corporation itself. *Central R. R., etc. Co. v. Smith*, 76 Ala. 572; 52 Am. Rep. 353.

¹ *Merchants' Nat. Bank v. Wehrmann*, 202 U. S. 295; 26 Sup. Ct. 613.

Cf. *Ex parte Liquidators of British Nation Life Ass. Ass'n*, 8 Ch. D. 679.

² *Kelley v. Biddle*, 180 Mass. 147; 61 N. E. 821.

But cf. *First Nat. Bank v. Converse*, 200 U. S. 425; 26 Sup. Ct. 306.

³ *White Star Line v. Star Line* (Mich.), 105 N. W. 135; 141 Mich. 604; 113 Am. St. Rep. 551 (semble).

Cf. *Catskill Bank v. Gray*, 14 Barb. (N. Y.) 471; *Bates v. Coronado Beach Co.*, 109 Cal. 160, 162-163; 41 Pac. 855.

⁴ *Marine Bank v. Ogden*, 29 Ill. 248 (semble).

Cf. *Bates v. Coronado Beach Co.*, 109 Cal. 160, 162-163; 41 Pac. 855; *Chicago, etc. Ry. Co. v. Ayres*, 140 Ill. 644; 30 N. E. 687 (indebtedness contracted jointly by connecting railways); *New York, etc. Canal Co. v. Fulton Bank*, 7 Wend. (N. Y.) 412 (deposit in bank in joint names of two corporations); *Johnston Foreign Patents Co.* (1904), 2 Ch. 234 (where three companies undertook to issue joint debentures).

⁵ *Belch v. Big Store Co.* (Wash.), 89 Pac. 174.

erosity or public spirit, to expend their funds for charitable or philanthropic objects; and this is true although, as from a casting of their bread upon the waters, a hope of indirect benefit to the company is indulged.¹ Thus, it is *ultra vires* of a railway company to make a donation to a fair or public exhibition to be set up along its line, although the establishment will increase the traffic over the line.² But although business corporations cannot contribute to charity or benevolence, yet they are not required always to insist on the full extent of their legal rights. They are not forbidden from recognizing moral obligations of which strict law takes no cognizance. They are not prohibited from establishing a reputation for broad, liberal, equitable dealing which may stand them in good stead in competition with less fair rivals. Thus, an incorporated fire insurance company whose policies except losses from explosions may nevertheless pay a loss from that cause when other companies are accustomed to do so, such liberal dealing being deemed conducive to the prosperity of the corporation.³

The extent of this power of corporations has been questioned most frequently with respect to gifts and gratuities to servants and agents. It is settled that a corporation may bestow reasonable gratuities on its employees in addition to the compensation to which they may be legally entitled.⁴ Thus, a manufacturing company may give a gratuity of one week's extra pay to each of its laborers who have worked for the company faithfully for more

¹ But cf. *Whetstone v. Ottawa University*, 13 Kan. 320 (donation to procure erection of a school near company's land). 140 Ill. 248; 29 N. E. 1044 (where an hotel company was held to have power to contribute to the expense of a public gathering); *Merchants' Bldg., etc. Co. v. Chicago Exchange Bldg. Co.*, 106 Ill. App. 17; 210 Ill. 26; 71 N. E. 22; 102 Am. St. Rep. 145 (holding that a corporation owning a large office building may contribute to a fund to secure the location of the public stock exchange in that vicinity).

As to power to dedicate property of the corporation as a highway, see *Stacy v. Glen Ellyn Hotel, etc. Co.*, 79 N. E. 133; 223 Ill. 546. ² *Tomkinson v. South Eastern Ry. Co.*, 35 Ch. D. 675; *Davis v. Old Colony R. R. Co.*, 131 Mass. 258; 41 Am. Rep. 221; *Western Md. R. R. Co. v. Blue Ridge Hotel Co.*, 102 Md. 307; 62 Atl. 351; 111 Am. St. Rep. 362 (railway company without power to contribute to erection of a summer hotel on its line).

³ *Tomkinson v. South Eastern Ry. Co.*, 35 Ch. D. 675; *Davis v. Old Colony R. R. Co.*, 131 Mass. 258; 41 Am. Rep. 221; *Western Md. R. R. Co. v. Blue Ridge Hotel Co.*, 102 Md. 307; 62 Atl. 351; 111 Am. St. Rep. 362 (railway company without power to contribute to erection of a summer hotel on its line).

⁴ *Taunton v. Royal Ins. Co.*, 2 Hem. & Mill. 135.

⁵ Cf. *Rainford v. James Keith & Blackman Co.* (1905), 2 Ch. 147 (where the gratuity took the shape of a loan to the employee).

But see *Richelieu Hotel Co. v. International, etc. Encampment Co.*, Minn. 140; 16 N. W. 854. But see *Jones v. Morrison*, 31

than a year.¹ So, a bank may grant a five years' pension to the family of one of its officers.² In all cases of these sorts, the amount of the gratuity rests entirely within the discretion of the company,³ unless indeed it be altogether out of reason and fitness. But where the company has ceased to be a going concern, this power to make gifts or presents is at an end. Thus, where a company has sold out its business and undertaking, and is about to be wound-up, a general meeting has no power to vote a portion of its funds to its directors, officers, and servants, in consideration of their past services and loss of positions.⁴ The reason for this is that where the company is about to discontinue its business those interested in it cannot be benefited by such gratuities, for no reputation for fair-dealing and generosity can further advantage them. As many American courts would say, the assets have become a "trust-fund" for the benefit of creditors and shareholders. Lord Bowen, with a homely Shakespearean phrase, has tersely indicated the reason of the law thus: "The law does not say that there are to be no cakes and ale, but there are to be no cakes and ale except such as are required for the benefit of the company."⁵

§ 88. **Gratuities to Directors.** — The same principles apply where the directors are the recipients of the company's bounty as in the case of inferior agents and servants,⁶ except that the gift must be made or approved by the shareholders; for of course the directors have no right to make themselves a present with the company's money.⁷ The question whether or not the gift should be authorized should be fairly and distinctly submitted to the shareholders.⁸ Indeed, some American cases seem to hold that the giving of a pure gratuity to directors is *ultra vires* of the corporation, so that it could not be legalized

¹ *Hampson v. Price's Patent Candle Co.*, 45 L. J. Ch. 437.

² *Henderson v. Bank of Australasia*, 40 Ch. D. 170.

³ *Henderson v. Bank of Australasia*, 40 Ch. D. 170, 181 (headnote inadequate).

⁴ *Hutton v. West Cork Ry. Co.*, 23 Ch. D. 654; *Stroud v. Royal Aquarium, etc. Soc.*, 89 L. T. 243.

Cf. *Missouri Pac. Ry. Co. v. Texas, etc. Ry. Co.*, 33 Fed. 701 (as

to gratuities paid by a receiver of a company).

⁵ *Hutton v. West Cork Ry. Co.*, 23 Ch. D. 654, 673.

⁶ Cf. *St. Louis, etc. R. R. Co. v. Tiernan*, 37 Kan. 606; 15 Pac. 544.

⁷ See *Doe v. Northwestern Coal, etc. Co.*, 78 Fed. 62.

⁸ *Kaye v. Croydon Tramways Co.* (1898), 1 Ch. 358; *Jackson v. Munster Bank*, 13 L. R. Ir. 118.

even by the approval of the shareholders; but this position has no sound reason to support it, and is opposed to the weight of authority.¹

§ 89. **Payment of Gratuities out of Capital.** — There seems on principle no reason to doubt that gifts or gratuities wherever they are lawful may be paid out of capital as well as out of profits. For the theory on which they are allowed is that they are proper payments in the prosecution of the company's business. Nevertheless, in an English case, it was said that although a corporation by a majority of its members in general meeting could make a present to its managing director for the maintenance of his private residence on the theory that the support of his social position would benefit the company, yet such a present could be made only out of profits which might be divided among the shareholders, and not out of capital.² It is doubtless true that if all the shareholders consent, money that might be divided among them as dividends may, instead, be applied to that or any other innocent purpose under the sun; but no reason is perceived why any payment to which the majority may bind the minority may not be made out of capital as well as out of accumulated profits.

§ 90. **Whether desirable to supplement implied Powers of this kind by express Provisions.** — Enough has been said to show that the implied powers of a corporation to give gratuities to its servants and officers, as well as to strangers, are ample, so that there is therefore no need to supplement them by express provisions. Indeed, any express power to make gifts or gratuities that should go beyond the power implied by the law would be very dangerous. Possibly, it might be well in some cases to confer expressly the power to make donations to fairs, exhibitions and similar enterprises that may be thought likely indirectly to benefit the company.

¹ *Huffaker v. Krieger's Assignee*, 53 S. W. Rep. 288; 107 Ky. 200; 46 L. R. A. 384. ² *George Newman & Co.* (1895), 1 Ch. 674, 686, per Lindley, L. J., approved in *Paton's Case*, 5 Ont. L.

Cf. *National Loan, etc. Co. v. R.* 392.

Rockland Co., 94 Fed. 335; 36 C. C. A. 670.

§ 91. **Power to Guarantee.** — The power to guarantee performance of contracts, etc., by customers of the company may often be found convenient in practice to exercise. It is not a power easily implied,¹ and yet to insert as one of the

¹ *Sturdevant v. Farmers', etc. Bank*, 87 N. W. 156; 62 Nebr. 472; 95 N. W. 819; 69 Nebr. 220 (bank acting as surety for customer on a replevin bond); *Bailey v. Farmers' Nat. Bank*, 97 Ill. App. 66; *National Bank of Brunswick v. Sixth Nat. Bank*, 212 Pa. St. 238; 61 Atl. 889 (bank guaranteeing drafts on customer for latter's accommodation); *Bank of Barnwell v. Sixth Nat. Bank*, 28 Pa. Super. Ct. 413 (same point); *J. G. Brill Co. v. Norton, etc. Street Ry. Co.*, 189 Mass. 431; 75 N. E. 1090 (accommodation endorsement by railway company of note of contractor); *Greene v. Middlesborough Town and Lands Co. (Ky.)* 89 S. W. 228 (attempt by a company formed for developing and dealing in real estate to guarantee dividends on stock of investment company); *First Nat. Bank v. American Nat. Bank*, 173 Mo. 153; 72 S. W. 1059 (guarantee by bank of draft on customer); *Bowen v. Needles Nat. Bank*, 94 Fed. 925; 36 C. C. A. 553 (agreement by bank to honor overdrafts by third person); *Park Hotel Co. v. Fourth Nat. Bank*, 86 Fed. 742; 30 C. C. A. 409; *Commercial Nat. Bank v. Pirie*, 82 Fed. 799; 27 C. C. A. 171 (bank guaranteeing account of customer with a merchant); *Rogers v. Jewell Belting Co.*, 184 Ill. 574 (where the surety corporation was composed of the same shareholders as the principal corporation); *Best Brewing Co. v. Klassen*, 185 Ill. 37; 57 N. E. 20; 76 Am. St. Rep. 26 (appeal bond); *M. V. Monarch Co. v. Farmers' etc. Bank (Ky.)*, 49 S. W. 317; 20 Ky. L. Rep. 1351 (accommodation paper); *Madison, etc. Co. v. Watertown, etc. Co.*, 7 Wisc. 59; *Preston v. Northwestern Cereal Co.*

(Nebr.), 93 N. W. 136; 67 Nebr. 45; *Louisville, etc. Ry. Co. v. Louisville Trust Co.*, 174 U. S. 552, 567-568; 19 Sup. Ct. 817 (semble); *Prospect Worsted Mills*, 126 Fed. 1011; *Kelley, Maus and Co. v. O'Brien Varnish Co.*, 90 Ill. App. 287 (executing appeal bond as surety); *Gilbert v. Seatco Mfg. Co.*, 98 Fed. 208 (attempt by corporation to become surety for a transferee of its shares for repayment of money advanced to enable him to purchase them); *Western Md. R. R. Co. v. Blue Ridge Hotel Co.*, 102 Md. 307; 62 Atl. 351; 111 Am. St. Rep. 362 (railway company guaranteeing interest on bonds and dividends on shares of a company erecting a summer hotel on the line of railway); *Washington Mill Co. v. Sprague Lumber Co.*, 52 Pac. 1067; 19 Wash. 165 (guaranty of debt of a shareholder concurred in by the other shareholders); *Appleton v. Citizens' Central Nat. Bank*, 116 N. Y. App. Div. 404; 101 N. Y. Supp. 1027 (guaranty of promissory note by a national bank); *National Bank of Newport v. H. P. Snyder Mfg. Co.*, 102 N. Y. Supp. 478 (accommodation paper issued by manufacturing company); *Cook v. Am. Tubing, etc. Co. (R. I.)*, 65 Atl. 641 (accommodation paper issued by manufacturing company for benefit of an agent); *Humboldt Mining Co. v. Am. Mfg., etc. Co.*, 62 Fed. 356; 10 C. C. A. 415 (company formed to manufacture iron work for mines guaranteeing contract for erection of mining plant for prospective customer); *Evans v. Johnson*, 149 Fed. 978; 79 C. C. A. 488.

But see *Murphy v. Arkansas, etc. Imp. Co.*, 97 Fed. 723 (where all the shareholders assented).

company's objects acting as surety for other persons would be very hazardous,¹ and might moreover subject the corporation to burdensome regulations applicable to surety companies. Moreover, in some cases, the power is implied as incidental.² We have seen above that any corporation owning a bill of exchange or promissory note or coupon-bond and desiring to assign the same may, by endorsement or otherwise, guarantee payment.³ So, it has been held that a company engaged in manufacturing and selling lumber may become surety on the bond of a contractor to whom it furnishes building material and who is required to give bond to secure performance of a contract.⁴ Similarly, a brewery company may go surety for a publican upon a bond necessary to secure him a license to sell the surety's liquors.⁵ It has even been held that a manufacturing company may lend its credit to a debtor who is in embarrassed circumstances,⁶ a decision which certainly goes to the extreme limit of the law. It has also been held that a company when

¹ But Sir F. B. Palmer recommends mentioning as one of the company's objects the exercise of "a power to lend money and guarantee the performance of contracts by customers and others." "These loan and guarantee transactions," he truly says, "are constantly called for in business and yet the power is one not easily implied." *Palmer's Company Law*, 3d ed., 47.

² *Central R. R., etc. Co. v. Farmers' L. & T. Co.*, 114 Fed. 263; 52 C. C. A. 149 (guarantee by railway company with banking powers of bonds of a railway in which the first company owned a majority of the shares); *Central Trust Co. v. Columbus, etc. Ry. Co.*, 87 Fed. 815 (mortgage of land to guarantee bonds of subsidiary company); *John Bridge & Co. v. Magrath*, 4 New So. Wales State Rep. 441 (guarantee by company of wool brokers of bank account of constituent).

Cf. *Schaeffer Piano Mfg. Co. v. Nat. Fire Extinguisher Co.*, 148 Fed. 159; 78 C. C. A. 293 (holding that manufacturing company may agree with contractor to insure his prop-

erty against loss by fire while it is on the premises of the first company).

³ See *supra*, § 77.

Cf. *Roosevelt v. Nashville, etc. Ry. Co.*, 128 Fed. 465 (where the transaction was held a sale so far as the purchaser of the bonds was concerned so as to entitle him to hold the guarantor company, although the guarantor immediately transmitted the proceeds of sale to the principal debtor).

⁴ *Wheeler v. Everett Land Co.*, 14 Wash. 630; 45 Pac. 316; *Central Lumber Co. v. Kelter*, 201 Ill. 503.

Cf. *Interior Woodwork Co. v. Prassar*, 108 Wisc. 557; 84 N. W. 833.

But see *contra*, *S. P. Smith Lumber Co.*, 132 Fed. 620.

⁵ *Horst v. Lewis* (Nebr.), 98 N. W. 1046; 103 N. W. 460.

Cf. *Aaronson v. David Meyer Brewing Co.*, 26 N. Y. Misc. 655; 56 N. Y. Supp. 387 (guaranteeing payment of rent by customer).

⁶ *Hess v. Sloane*, 66 N. Y. App. Div. 522; 73 N. Y. Supp. 313; affirmed 173 N. Y. 616; 66 N. E. 1110.

purchasing property has implied power as part of the consideration to indorse or guarantee notes of the vendor,¹ but this decision overlooks the fact that the objection to guarantees by corporations does not lie merely in the fact that the company receives no benefit,² but also in the fact that a corporation has no implied power to speculate upon the ability or inability of a third person to meet his obligations.³ It has been held that a company which has power to purchase shares in another corporation may, as part of the consideration for the purchase, agree to guarantee dividends on other stock of the second company,⁴ a decision which is likewise rather questionable. Of course when the corporation is in fact the principal debtor, there is no legal objection to the execution of commercial paper whereby the company appears in form as an accommodation indorser.⁵ An express power to aid other corporations, by subscription to their stock or otherwise, confers power to guarantee their bonds.⁶

§ 92. **Power to Lend.** — The power to lend money is closely akin to the power to lend credit by executing a guarantee,⁷ and like the latter power is not readily implied.⁸ Nevertheless, a company formed for the purpose of "brewing and selling beer" was held to have implied power to lend money to a saloon-keeper for the erection of a saloon at which the company's beers should be sold.⁹ A loan may be a proper form of investment for

¹ *National Bank of Commerce v. Allen*, 90 Fed. 545; 33 C. C. A. 169. Cf. *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 246-248; 23 Atl. 287.

² Cf. *Deaton Grocery Co. v. International Harvester Co.* (Tex.) 105 S. W. 556. But see *Lyon v. First Nat. Bank*, 85 Fed. 120; 29 C. C. A. 45.

³ Of course, a corporation on purchasing property has power to assume the payment of a mortgage thereon, as was done in *Beaver Knitting Mills*, 154 Fed. 320; *Panhandle Nat. Bank v. Emery*, 78 Tex. 498; 15 S. W. 23; but this is very different from guaranteeing payment.

⁴ *Windmuller v. Standard Distilling Co.*, 106 N. Y. App. Div. 246; 94 N. Y. Supp. 52.

⁵ *Beacon Trust Co. v. Souther*, 183 Mass. 413; 67 N. E. 345.

⁶ *Zabriskie v. Cleveland, etc. R. R. Co.*, 23 How. 381.

⁷ Cf. *Holmes v. Willard*, 125 N. Y. 75; 25 N. E. 1083; 11 L. R. A. 170.

⁸ *Grand Lodge v. Waddill*, 36 Ala. 313; *Chambers v. Falkner*, 65 Ala. 448, 454; *Beach v. Fulton Bank*, 3 Wend. (N. Y.) 573, 582-583 (semble).

⁹ *Kraft v. West Side Brewery Co.*, 219 Ill. 205; 76 N. E. 372. For other cases where the power to lend has been implied, see *Holmes v. Willard*, 125 N. Y. 75; 25 N. E. 1083; 11 L. R. A. 170; *Western Boatmen's, etc. Ass'n v. Kribben*, 48 Mo. 37, 43; *Union Water Co. v.*

such corporations as insurance companies,¹ and indeed it has been held that a manufacturing company has implied power to lend its surplus funds temporarily.² Of course, any corporation may deposit money with its bankers, and yet an ordinary bank deposit is a loan to the bank. Moreover, a company may lend money to a faithful employee as an indirect method of giving him a gratuity.³ The power to lend necessarily implies the power to take any reasonable security that is not prohibited.⁴ But an express power to lend on bond and mortgage so far from implying rather negatives any power to lend without security or on some different security.⁵

§ 93. **Power to advertise.** — The power to advertise is incidental to all business companies,⁶ and need never be expressly mentioned in the incorporation paper.

§ 94. **Power to promote or oppose Bills in the Legislature.** — Sometimes, the majority of the shareholders resort to the legislature for assistance in dealing with an (as they think) obstreperous minority, and undertake to defray the expense of applying for the legislative aid out of the company's funds. This is *ultra vires* of the corporation; and, therefore, although citizens cannot be enjoined from applying to the legislature for an amendment to their act of incorporation or for redress of any grievances, real or fancied, yet the expenditure of moneys of the corporation for that purpose will be restrained by a court of equity at the instance of any shareholder.⁷ Indeed, it is held that a corporation should content itself with the existing law, and has therefore no power to expend its funds in promoting a bill in parlia-

Murphy's Flat, etc. Co., 22 Cal. 620; 35 Am. Rep. 531; *Pratt v. Eaton, Madison, etc. Co. v. Watertown, etc. Co.*, 5 Wisc. 173.

¹ *Farmers' L. & T. Co. v. Perry*, 3 Sandf. Ch. (N. Y.) 339; *North Carolina R. R. Co. v. Moore*, 7 N. Car. 6 (railway company); *Life Ass'n v. Levy*, 33 La. Ann. 1203; *Farmers' L. & T. Co. v. Clowes*, 3 N. Y. 470.

² *Garrison Canning Co. v. Stanley* (Iowa), 110 N. W. 171.

³ *Rainford v. James Keith & Blackman Co.* (1905), 2 Ch. 147.

⁴ *Deloach v. Jones*, 18 La. 447. Cf. *Pratt v. Short*, 79 N. Y. 437;

⁵ *Life & Fire Ins. Co. v. Mechanic Ins. Co.*, 7 Wend. (N. Y.) 31.

⁶ See *Colorado Springs Co. v. American Publishing Co.*, 97 Fed. 843; 38 C. C. A. 433.

⁷ *Caledonian Ry. Co. v. Solway Ry. Co.*, 49 L. T. 526; *Stevens v. South Devon Ry. Co.*, 20 L. J. Ch. 491; *Great Western Ry. Co. v. Rushout*, 5 De G. & Sm. 290. It is otherwise, however, if the amendatory act has been passed. *Hattersley v. Shelburne*, 31 L. J. Ch. 873, 883-884; *White v. Carmathan Ry. Co.*, 1 Hem. & Miller 786.

ment for any purpose, however beneficial to the company's business its passage might be.¹ However, it would seem clear that a corporation may devote a part of its funds to defeating any bill which it deems on reasonable grounds to be inimical to its interests.² And where a corporation may be organized for any lawful purpose, no reason is perceived why its incorporation paper may not by express provision empower it to promote bills in the legislature; but it may well be doubted whether even an express provision in the incorporation paper could authorize the majority of the company to use the corporate funds to secure legislative aid in their controversies with the minority. The question is of less importance in the United States than in England, not only because constitutional limitations on the power of the legislature afford some protection to the minority, but also because the legitimate expenses of procuring an act of the legislature are much smaller in America than in Great Britain.

§ 95. **Power to inform Shareholders of Facts likely to influence their Votes.** — Although a company has no power to participate in factional disputes between its members, yet it may always, even without express authorization employ its funds in giving any information to its shareholders that may affect their interests or influence their conduct as members. For example, a corporation has power to expend its funds in order to inform its shareholders of a proposition to give stock in a rival company in exchange for their shares, thus effecting a virtual amalgamation.³ The court said: "When it comes to the knowledge of a board of directors that some scheme is on foot to induce a majority of the stockholders to part with their stock to a rival corporation, the directors are not only authorized to advise the stockholders thereof, but it is their duty to do so. . . . Undoubtedly individual stockholders receive a benefit in being notified of what is going on, but, in our opinion, the corporation itself also receives a benefit in having its stockholders at all times fully advised as to everything which concerns its condition, or which may be expected to alter that condition.

¹ *Munt v. Shrewsbury, etc. Ry. Co.*, 13 Beav. 1; *Maunsell v. Midland, etc. Ry. Co.*, 1 Hem. & Mill. 130.

² *Attorney-General v. Mayor of Brecon*, 10 Ch. D. 204.

³ *Rascover v. American Linseed Co.*, 135 Fed. 341; 68 C. C. A. 11.

We would not hesitate to hold it a legitimate charge against a corporation if directors should send to every stockholder a printed copy of a report as to its condition, or even as to general conditions of the industry in which it operated, so that all might be advised as to what environment, favorable or adverse, surrounded it, in the hope that some of them might thereby be stimulated to thought and suggestion by which the corporation might itself be profited."¹ This being the law, "whether the notice shall be long or short, in what form of words it shall be couched, whether it shall be sent by mail or advertisement in newspapers, are matters of detail, which should be left to the directors"; and therefore a claim against a company for over \$20,000 for the expense of advertising such a notice in newspapers has been sustained.² So, too, the directors may properly expend the company's funds in sending out to each shareholder a circular setting out the facts with reference to certain questions of policy in the management of the company and also advocating their own views and asking the support of the several shareholders.³ On the other hand, it has been held that the funds of the corporation cannot be used in publishing a reply to a circular issued by an officer in an effort to prevent the re-election of the directors.⁴

§ 96. **Power to take Measures to bring out full Vote at Shareholders' Meeting.** — The directors may also adopt any appropriate measures for the purpose of bringing out a full and fair vote at a shareholders' meeting, and may consequently send out to the shareholders stamped proxy papers containing the names of some of their own number as proxies, with a stamped cover for return.⁵ The difference of judicial opinion which has existed with respect to this latter point illustrates the difficulty in drawing the line between acts which are a legitimate effort to support policies deemed to be beneficial to the company and acts which are an improper endeavor to

¹ 135 Fed. 341, 343-344.

⁵ *Peel v. London & N. W. Ry.*

² *Rascover v. American Linseed Co.* (1907), 1 Ch. 5 (overruling *Studdert v. Grosvenor*, 33 Ch. D. 528).

³ *Peel v. London & N. W. Ry.* Cf. *Jackson v. Munster Bank*, 13 Co. (1907), 1 Ch. 5. L. R. Ir. 118; *Lawyers' Advertising*,

⁴ *Lawyers' Advertising Co. v. etc. Co. v. Consolidated Ry., etc. Co., Consolidated Ry., etc. Co.*, 80 N. E. 80 N. E. 199; 187 N. Y. 395. 199; 187 N. Y. 395.

perpetuate the power of the faction which happens to be in control of the company for the time being. It has been held in New York that while directors may properly send out proxies to the shareholders yet they must not use the company's funds in urging the shareholders to return the proxies in order to keep themselves in office.¹

§ 97. **Power to pay Counsel-fees in internal Contest.** — A corporation may expend its funds in paying the fees of defendant's counsel in a suit to oust some of the officers of the company.² So to do is not deemed unlawful participation in a factional dispute between members of the corporation.

§ 98-§ 102. *Power to make the Best of a Situation.*

§ 98. **In general.** — As the limitations upon the powers of corporations are not intended as mere vexatious impediments, but are designed as helps rather than hindrances to the business, the powers should not be so construed as to prevent corporations from extricating themselves in the most practicable way from any difficulties by which without their fault they may be beset. This principle may lead a company into transactions that seem far removed from the objects of its creation, but nevertheless they are not *ultra vires*. Although *prima facie* beyond its powers, yet they are seen on a thorough examination of the attendant circumstances to be in fact reasonably incidental to the successful prosecution of the company's undertaking, and therefore *intra vires*. "Take, for instance," said Lord Justice Selwyn, "the common case of a banker advancing money upon the security of a ship and the freight. Nothing, probably, would be further from the notion of the banker than entering into any transaction respecting the sailing of the ship, or receiving the freight in respect of that ship. But if he is obliged to foreclose his security, if he is obliged to take possession of the ship, then, as a prudent man, he would necessarily become involved in the management of the sailing of the ship and receiving the freight as constituting the only means by which he could recover the money he had advanced. I may mention one very familiar

¹ *Lawyers' Advertising, etc. Co. v. Consolidated Ry., etc. Co.*, 80 N. E. Ass'n, 116 La. 974; 41 So. 228. 199; 187 N. Y. 395. ² *Stendell v. Longshoremen's, etc.*

instance, known to us all, that of a well-known insurance company. Having lent money upon the security of a mortgage of land in Galway, and having been obliged to foreclose that mortgage, they became dealers of land in Galway on a very large scale.”¹ This inherent power of every corporation to make the best of a situation and to protect itself from loss is far-reaching and might be illustrated by many examples,² and indeed instances of it have been already given more than once. Further examples are mentioned below.

§ 99. **Power to utilize surplus Property.** — For instance, a corporation is not bound to let its surplus property lie idle, but may put it to the most profitable use practicable.³ Thus, a railway company having power to maintain a ferry in connection with its line may employ the ferry-boats, when not in use for their proper purpose, in carrying passengers for hire on excursions.⁴ So, a railway company may rent out its machines for weighing coal whenever it is not using them.⁵ An hotel company may let to a government department a large part of its hotel while it is in course of construction;⁶ or a brewery company, having need of an office, may lease an entire house and sublet all except the ground-floor.⁷ According to the same principle, if a company has surplus funds in its hands, for the time being not needed in its business, it is not bound to keep them in its safe or even at its bankers, but may invest them in

¹ *Royal Bank of India's Case*, 4 Ch. 252, 260-261. ing a mortgage may buy in prior mortgage to prevent foreclosure).

² In addition to cases cited below, see *Mahoney v. Butte Hardware Co.*, 27 Mont. 463; 71 Pac. 674; *Fidelity Ins. Co. v. German Savings Bank*, 127 Iowa 591; 103 N. W. 958; *Westminster Nat. Bank v. New England Electric Works*, 62 Atl. 971; 73 N. H. 465; 111 Am. St. Rep. 637; *Cockrill v. Abeles*, 86 Fed. 505; 30 C. C. A. 223; *Attorney-General v. Mersey Ry. Co.* (1907), 1 Ch. 81; *State Security Bank v. Hoskins*, 106 N. W. 764; 130 Iowa 339 (bank accepting conveyance of farm in satisfaction of debt); *Mayor, etc. of Baltimore v. Baltimore & O. R. R. Co.*, 21 Md. 50 (corporation hold-

³ *People ex rel. Maloney v. Pullman Car Co.*, 175 Ill. 125; 51 N. E. 664; 64 L. R. A. 366.

⁴ *Forrest v. Manchester, etc. Ry. Co.*, 30 Beav. 40 (affirmed on other grounds in 4 De G. F. & J. 125). Cf. *Brown v. Winnisimmet Co.*, 11 Allen (Mass.) 326 (ferry company may let out boat which is not needed for present use).

⁵ *London & N. W. Ry. Co. v. Price*, 11 Q. B. D. 485.

⁶ *Simpson v. Westminster Palace Hotel Co.*, 8 H. L. C. 712.

⁷ *Horsey's Claim*, 5 Eq. 561, 562 n (headnote inadequate).

any sound securities, not of course for speculation but purely as an investment, to prevent the money from lying idle.¹

§ 100. **Power to Compromise.** — Moreover, a corporation has power to compromise any claim against it on the best terms it can obtain,² and this is true although thereby a reduction of capital or some other result ordinarily *ultra vires* is brought about. Thus, where a claim is made against a company on account of an alleged illegal issue of shares, a compromise may be entered into whereby the shares in question are to be cancelled, although in point of fact the shares were valid.³

§ 101. **Limits of Powers to make the best of a Situation.** — A limit of course exists to the powers of the sort considered in the last few paragraphs; and in some cases the limit has been drawn perhaps too closely. Thus, where a building society which had made a loan upon security of a second mortgage of real estate, in order to prevent a sale of the premises at a sacrifice under the first mortgage, agreed to guarantee the payment of the same, the House of Lords held that the guarantee was *ultra vires* of the association, and therefore unenforceable.⁴ Moreover, where a bank has obtained title to real estate in payment of a debt, although it may lay out money for ordinary and reasonable repairs, yet it has no power to spend its funds in prospecting for ore on the land.⁵ Similarly, a corporation which owns shares in another company cannot extend pecuniary assistance to the latter even in order to prevent its ruinous failure.⁶

§ 102. **Whether desirable to supplement these Powers.** — These cases, and others of a similar sort, show that too great reliance can easily be placed upon a company's inherent powers of making the best of a bad situation. Sometimes, it may be well in drawing up an incorporation paper to supplement the powers that would be implied, by express provisions covering such difficulties as can be anticipated. Thus, an English text-writer,

¹ Cf. *supra*, § 82.

² Cf. *supra*, § 82.

³ *Bath's Case*, 8 Ch. D. 334.

See *infra*, § 637.

⁴ *Small v. Smith*, 10 A. C. 119.

Cf. *West of England Bank*, 14 Ch.

D. 317; *Stark Bank v. U. S. Pottery*

Co., 34 Vt. 144.

As to the power to guarantee

securities of other corporations, see *Marbury v. Kentucky Union Land Co.*, 62 Fed. 335. As to power to guarantee in general, see *supra*, § 91.

⁵ *Cooper v. Hill*, 94 Fed. 582; 36 C. C. A. 402.

⁶ *Salomons v. Laing*, 12 Beav.

having in mind, possibly, the decision of the House of Lords stated in the last paragraph, recommends that the incorporation paper contain a clause empowering the company to "guarantee the performance of contracts by customers and others";¹ but, as already pointed out,² this seems a rather dangerous power to confer without restriction. Perhaps, in general, it is better to rely on the implications of the law. At all events, in deciding this question, the draftsman of an incorporation paper should be influenced largely by the peculiar circumstances, so far as they can be foreseen, of the particular company, and needs business foresight as well as legal knowledge and skill.

§ 103. **Provisions prohibiting Exercise of Powers that might otherwise be implied.** — Finally, it is always possible by positive prohibition to exclude the existence of powers that would otherwise be implied. To be sure, the powers which are incidental to corporate existence and which the statutes usually affirmatively declare that all companies organized under them shall have — such as the power to sue and be sued, to have continuous succession, to have and use a common seal, and the like — cannot be excluded. But any powers that are implied merely as appropriate means towards attaining the expressed objects may by positive prohibition be denied to the company. For only such powers are implied as are reasonably necessary to the accomplishment of the ends of the company's existence and as are not expressly prohibited.

§ 104-§ 108. GENERAL STATEMENTS OF OBJECTS.

§ 104. **Particularity requisite in stating Objects.** — The intent of every general incorporation law being that the objects of the proposed company shall be specified in its incorporation paper, a statement that its objects shall be the prosecution of any business that the company may see fit, or other words to that effect, would certainly fail to satisfy the statute. The objects must be specified or mentioned, and a declaration that the objects shall be whatsoever the corporation may choose could

¹ Palmer's Company Law, 3d ed., 47.

² Supra, § 91.

not possibly be deemed a compliance with the law.¹ Thus Lord O'Hagan in a leading case in the House of Lords said: "That Act (the Companies Act of 1862) gave certain privileges and imposed certain conditions, and one of them was, that the memorandum of association should specify the objects of men seeking to trade with limited liability, for the manifest purpose that those objects should be clear and definite, and known precisely to all who might have dealings with the company. But if in a case like this, it were competent for persons making and registering a memorandum to segregate particular words, as 'contractor' and 'merchant,' and insist that their generality should be confined not by the declared purposes of the formation of the company, nor even by the manifest reason of the thing, the purpose of the Act would be defeated, and the favor given by it would be enjoyed without fulfilment of the condition properly imposed for the public benefit."² So, a provision that the object of the company should be to do any and all acts tending to increase the value of its shares would certainly be too indefinite.³

To be sure, it is very difficult to say precisely what degree of particularity is requisite.⁴ Thus, a statement that the company is organized "for the purpose of manufacturing" has been held

¹ *Crown Bank*, 44 Ch. D. 634; *Re Journalists Fund of Philadelphia*, 8 Phila. 272; *Welsbach Incandescent Gas Light Co.* (1904), 1 Ch. 87, 99 (semble).

Cf. *State v. Central Ohio, etc. Ass'n*, 29 Ohio St. 399 (statement that the manner of carrying on the business shall be such as the company may from time to time prescribe by rules and regulations, held not a compliance with a requirement that the incorporation paper must show the "manner of carrying on the business of said association").

² *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653, 690-691.

³ *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 239 (semble); 23 Atl. 287; *Peel's Case*, 2 Ch. 674 (semble).

⁴ In the following cases in addition to those cited below, the state-

ment of objects was held too vague; *West v. Bullskin Prairie Ditching Co.*, 32 Ind. 138 (description of drain to be constructed by a drainage company held too indefinite); *O'Reiley v. Kankakee Valley Draining Co.*, 32 Ind. 169, 192-195 (similar point to that in preceding case); *Crawford v. Prairie Creek Ditching Ass'n*, 44 Ind. 361 (same point — commencement, course and terminus of ditch required to be stated); *Monroe Republican Club*, 6 Pa. Dist. R. 515 ("social enjoyment"); *LaFayette Club*, 21 Pa. Co. Ct. Rep. 243 ("mutual improvement intellectually, and social enjoyment").

In the following cases, in addition to those cited below, the statement of objects was held to be sufficiently particular: *Seyberger v. Calumet Draining Co.*, 33 Ind. 330 (description of drain to be con-

to be a compliance with law;¹ and the same is true of a statement that the objects of the company shall be the manufacture and sale of daguerreotype matting and preservers, and all other articles made of brass, silver, gold, iron, or other metals or any compounds thereof,² and of a statement that the objects of the company are "the mining of gold, silver and lead in the territory of Utah."³ According to a recent Wisconsin case, a statement that the "business or purposes" of the corporation will be "to construct and operate street railways in the city of Milwaukee and elsewhere in the State, and to extend its lines into or through any village or town of the State" is good, without mentioning the termini of the railways.⁴ Where an incorporation paper provided that the company's objects should be to buy and sell shares in a certain other corporation, "to exercise in respect to said shares any and all the rights, powers and privileges of owners of shares of said capital stock, to do any and all things tending to increase the value of the shares of the capital stock of said company," the words in quotation marks were held to be sufficiently definite as a specification of the objects of the corporation.⁵ On the other hand, a statement that the

constructed by drainage company sufficiently definite); *Callender v. Painesville & Hudson R. R. Co.*, 11 Ohio St. 516 (description of route of railway); *Baile v. Calvert College Educational Soc.*, 47 Md. 117, 122 ("to erect and maintain an educational society"); *Bowman Dairy Co. v. Mooney*, 41 Mo. App. 665, 672 (where the court said, *obiter*, "would it be a sufficient compliance . . . to state that the plaintiff intended to embark in some business not otherwise specially provided for by the corporation law of the State? We think not"); *New York, etc. R. R. Co. v. O'Brien*, 106 N. Y. Supp. 909 (under statute requiring termini of proposed railway to be specified, held sufficient to mention the towns or villages which are the termini).

Cf. *Wendel v. State*, 62 Wisc. 300, 304-305; 22 N. W. 435 (where the court said, "It is not necessary that the articles of association shall designate with particularity all the

powers which it may exercise when duly incorporated. It is sufficient if they designate in general terms the purposes for which the corporation is organized"); *Cayuga Lake R. R. Co. v. Kyle*, 64 N. Y. 185 (where a railway company was held a corporation *de facto* notwithstanding a lack of definiteness in stating the termini).

¹ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316 (headnote inadequate).

But see *Glenwood Coal Co.*, 6 Pa. Co. Ct. Rep. 575.

² *Bird v. Daggett*, 97 Mass. 494.

³ *People ex rel. Belknap v. Beach*, 19 Hun (N. Y.) 259.

⁴ *Milwaukee Light, Heat & Traction Co.* (Wisc.), 112 N. W. 663, 669. Note that the rule would be different under some statutes. See cases collected *supra*, p. 94, note 4.

⁵ *Ellerman v. Chicago Junction Rys., etc. Co.*, 49 N. J. Eq. 217, 238-241; 23 Atl. 287.

corporation is formed for charitable purposes, has been held too vague as a specification of the objects of incorporation.¹ Similarly, where the law requires the objects of the company to be specified, a company cannot be incorporated for the "promotion of literature and the cultivation of friendly feelings."² Lord Lindley has expressed the opinion that consistently with honesty no company could be formed with objects so general as "working mines of any kind in any part of the world."³ In some cases, the name of the company may render sufficiently particular a statement of objects that would otherwise be too indefinite.⁴ If the company is expected to enjoy the franchise of condemning private property, the need of particularity in the specification of the objects is the greater.

§ 105-§ 108. *Construction of General Words accompanied by Particulars.*

§ 105. **Particular Words followed by General Words which standing alone would be too indefinite.** — Very often the object clause of the incorporation paper, after mentioning certain particular objects, concludes with general authority to do anything else that the company may choose, or may deem incidental to the particularized purposes, or the like. In all such cases, the concluding general words are not to be construed literally; for if so, according to the principles stated in the last paragraph, the instrument would not be in legal form. The maxim, *noscitur a sociis*, should be applied. For instance, where the objects of a company are stated to be to make and sell railway carriages and machinery and to carry on the business of "general contractors," the latter words do not confer a general power of making contracts without regard to their subject-matter, but will be confined in their application to such contracts as are incidental to the more explicit objects of the

¹ *Re Devaux*, 54 Ga. 673 (head-note inadequate).

Cf. *McKees Rocks, etc. Relief Ass'n*, 6 Pa. Dist. Rep. 477 (attempt to form a corporation for "beneficial or protective purposes to its members from funds collected therein").

² *National Literary Ass'n*, 30 Pa. St. 150. Cf. *Nether Providence Ass'n*, 12 Pa. Co. Ct. Rep. 666 ("social enjoyment").

³ *Coolgardie Gold Mines*, 76 L. T., N. S., 269, 271.

⁴ Cf. *Van Pelt v. Home Bldg., etc. Ass'n*, 79 Ga. 439; 4 S. E. 501.

company.¹ So, a provision that the corporation may do anything that the directors or a majority of the shareholders deem conducive to its objects does not make their judgment conclusive as to whether or not a certain transaction is conducive thereto, but authorizes the doing of such things only as are *bona fide* and reasonably connected with the objects to be attained:² such sweeping general words add little or nothing to the powers which the law would imply without them. *A fortiori*, a provision that the corporation may do whatever is incidental or conducive to its expressed objects merely declares and emphasizes a well-settled rule of legal interpretation.³

§ 106. **General Words followed by Particulars.** — The same rule will be applied where the general expressions precede instead of following the particular objects. Thus, a provision in an incorporation paper that the company shall possess the same powers as an individual in respect to making contracts, etc., is limited by a subsequent provision defining the business of the company as developing and dealing in real estate, to such contracts as are fairly incidental to the business of the company as thus defined.⁴

§ 107. **General Words which, although accompanied by Particulars, are not too indefinite to stand alone.** — The principle by which general words will be confined in scope to things *eiusdem generis* with the more particular terms by which they are accompanied will be applied not only where the general words are so very general that no other interpretation would be permissible, but also in any case where the court can see that the company was designed to have certain definite objects to which

¹ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653.

² *Joint Stock Discount Co. v. Brown*, 3 Eq. 139, 150-151 (headnote inadequate); *Guinness v. Land Corporation*, 22 Ch. D. 349, 373.

Cf. *London Financial Ass'n v. Kelt*, 26 Ch. D. 107, 137-138; *Peruvian Rys. Co. v. Thames*, 2 Ch. 617.

See also *Featherstonebaugh v. Lee Moor, etc. Co.*, 1 Eq. 318, where the court considered a provision in a deed of settlement under the Companies Act of 1844, purporting to

authorize a two thirds majority of the shareholders to add to or amend the deed, and generally to do anything that the company or all the shareholders by unanimous consent might do.

³ *Kingsbury Collieries and Moore's Contract* (1907), 2 Ch. 259 (headnote inadequate).

But see, as to such provisions, *Simpson v. Westminster Palace Hotel Co.*, 8 H. L. Cas. 712; *Baglan Hall Colliery Co.*, 5 Ch. 346, 356.

⁴ *Greene v. Middleborough Town & Lands Co. (Ky.)*, 89 S. W. 228.

everything else should be ancillary.¹ Thus, where a company was formed to engage in mining and "more particularly" to carry out an agreement for the purchase of a certain mine in New Zealand, it was held that the intended grantors of the mine having been proved to be without title thereto, the company had no power to engage in mining elsewhere.² So, where a company was organized to acquire and work a German patent for manufacturing a substitute for coffee, and any modifications and improvements thereof, and to acquire any other inventions for similar purposes, and to import and export all descriptions of produce for the purpose of food, it was held that the latter clause should be construed as merely ancillary to what preceded, and that, the German government having refused to grant the patent, there remained no business in which under the true construction of the incorporation paper the company could lawfully engage.³ So, where an incorporation paper stated that the objects of the company were to acquire the assets and liabilities of

¹ In addition to cases cited below, see *Moore v. Rawlins*, 6 C. B., N. S., 289; *Stephens v. Mysore Reefs Mining Co.* (1902), 1 Ch. 745 (an extreme case, which has lately been criticised and distinguished in *Pedlar v. Road Block Gold Mines* (1905), 2 Ch. 427); *Haskell v. Worthington*, 94 Mo. 560, 569; 7 S. W. 481 (head-note inadequate); *Coolgardie Gold Mines*, 76 L. T., N. S., 269 ("Where a company puts in the forefront of its memorandum of association a special object, as to which definite information can be obtained by intending subscribers for shares, and the subsequent clauses of the memorandum contain a list of general objects, the reasonable mode of construing the memorandum in ordinary cases is to say that the object first stated is the paramount object of the company and that the other objects are ancillary and subservient to that object").

But see *Stern v. McKee*, 70 N. Y. App. Div. 142; 75 N. Y. Supp. 157.

² *Haven Gold Mining Co.*, 20 Ch. D. 151.

³ *German Date Coffee Co.*, 20 Ch. D. 169. Said Jessel, M. R.: "It appears to me that this memorandum when fairly read, and notwithstanding the rather loose use of general words, is simply to buy this patent and to work it either with or without improvements." 20 Ch. D. 185. Lindley, L. J., said: "In construing this memorandum of association or any other memorandum of association in which there are general words, care must be taken to construe those general words so as not to make them a trap for unwary people. General words construed literally may mean anything; but they must be taken in connection with what are shown by the context to be the dominant or main objects. It will not do under general words to turn a company for manufacturing one thing into a company for importing something else, however general the words are." 20 Ch. D. 188.

See also to substantially the same effect: *Consolidated Copper Co. v. Peddie*, 5 Rettie 393, 400.

certain other corporations formed for dealing in seats and accommodations for the Diamond Jubilee of Queen Victoria, and also "to carry on all kinds of promotion business," "to act as house-agents, surveyors, and builders," and to deal in places of observation for any procession or spectacle, the court held that from the whole instrument the primary object of the company appeared to be speculation in seats for the Diamond Jubilee and that everything else, in spite of the generality of the language used, was merely subordinate thereto, so that, the Diamond Jubilee having taken place, there remained nothing for the company to do.¹ Upon the same principle, a clause in the incorporation paper of a sawmill company purporting to authorize the corporation to own or lease railways and tramways has been declared to apply only to such railways or tramways as are incidental to the operation of a sawmill.² In determining what is the main object of the company within the meaning of these decisions, the corporate name may furnish a guide.³

The same principle will apply to the construction of general words following more particular and limited statements of objects even where the incorporation paper provides that the objects specified in each paragraph, or subdivision, of the objects clause "shall be in nowise limited or restricted by reference to or inference from the terms of any other paragraph or the name of the company."⁴

§ 108. *Limits of Maxim Noscitur a sociis.*—On the other hand, the principle of *noscitur a sociis* must receive a reasonable application. For instance, it cannot be applied so as to effect a virtual deletion of the words "and elsewhere" in an incorporation paper specifying as the objects of the company, in addition to taking over as a going concern a certain named mine, the acquisition and development of gold mines and other mining rights "in Mysore and elsewhere."⁵ So, where an incorporation paper states as the purposes of the company the pur-

¹ *Amalgamated Syndicate* (1897), 1 Ch. 745 (distinguished and in some particulars criticised in *Pedlar v. Road Block Gold Mines* (1905), 2 Ch. 427).

² *People ex rel. Loy v. Mount Shasta Mfg. Co.*, 107 Cal. 256, 258; 40 Pac. 391.

³ *Re Crown Bank*, 44 Ch. D. 634.

See also *infra*, § 462.

⁴ *Stephens v. Mysore Reefs Min-*

ing Co. (1902), 1 Ch. 745 (distinguished and in some particulars criticised in *Pedlar v. Road Block Gold Mines* (1905), 2 Ch. 427). But see *Coolgardie Consol. Gold Mines*, 76 L. T. 269.

chase and operation of a certain mine in New South Wales and also the purchase of other mines in New South Wales or elsewhere, it was held that upon the exhaustion of the mine first named the company had power to acquire other lands in New South Wales believed to be coal bearing.¹

§ 109–§ 113. *The Capital Clause.*

§ 109. **Statement of Amount of Capital and Number of Shares.**—Second only in importance to the objects clause is the capital clause of the incorporation paper. This it is which defines the amount of the capital and the number and amount of the shares into which it is divided. The amount of the capital must be stated in the body of the instrument,² as the court cannot infer the amount of the capital from the number of shares subscribed for by the incorporators at the foot of the paper.³ An incorporation act providing that the memorandum of association shall state the amount of the company's capital "divided into shares of a certain fixed amount" requires the amount or par value of the shares to be stated in the incorporation paper.⁴ Care should be taken to avoid any inconsistency between the statement of the aggregate amount of the capital and the statement of the number and par value of the shares. In a Maryland case, an incorporation paper stated that the capital stock of the company should consist of \$150,000 divided into "five hundred shares at \$100 per share." The court held that *five* hundred was a clerical error for *fifteen* hundred, and that therefore the instrument was legal;⁵ but this conclusion could hardly have been reached but for the fact that appended to the paper was a subscription for "*fifty shares five thousand dollars.*"

¹ *Wickham & Bullock Island Coal Co.*, 5 New So. Wales State Rep. 365.

² But cf. *Lord v. Essex Bldg. Ass'n*, 37 Md. 320, 326–327 (headnote inadequate), where under a statute providing for the formation of building societies and declaring that any corporation formed thereunder should have power to state in the incorporation paper the number of shares of which its capital stock should consist, not exceed-

ing one thousand, and the par value thereof, the court held that an incorporation paper which provided that the number of shares should be indefinite was effective to create a corporation.

³ *State ex rel. Howe v. Shelbyville, etc. Turnpike Co.*, 41 Ind. 151.

⁴ *Financial Corporation*, 2 Ch. 714, 732 (headnote inadequate).

⁵ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316.

§ 110. **Division of Shares into Preferred and Common, etc.** — Another matter often regulated by the capital clause of the incorporation paper is the classification of the shares into “preferred” and “common” or “ordinary.” The many and difficult questions that arise in connection with this subject are, however, by reason of their importance reserved for separate and detailed treatment hereafter.¹

§ 111. **Statement as to Liability of Shareholders.** — In England and in some of the United States, the incorporation paper must contain a statement whether the liability of the members is to be limited or unlimited, or if limited to what extent it is to be confined.² In Colorado, where the statute provided that the incorporation paper should state whether the stock is to be “assessable” or “non-assessable,” it was held that a total omission from an incorporation paper of any statement upon this point did not prevent the corporation from attaining at least a *de facto* existence.³

§ 112. **Statement of Time and Manner of Payment for Shares.** — Some statutes require the time and manner of payment for the shares to be specified in the incorporation paper.⁴ A statement that the stock shall be paid for in cash and that no share-certificate shall issue until payment be made satisfies such a requirement;⁵ and the same is true of a statement that payment shall be made at such times and in such amounts as the directors may deem best.⁶ A statute requiring an affidavit to be endorsed upon the incorporation paper attesting the payment of five per cent of the minimum capital of the company is repealed by a subsequent statute which expressly repeals the provision requiring the payment of five per cent of the minimum subscription, but does not in express terms dispense with the affidavit.⁷

Ordinarily, and in the absence of an explicit statutory require-

¹ *Infra*, Chapter X, § 525 et seq. the stock, see *Buffalo, etc. R. R. Co. v. Hatch*, 20 N. Y. 157.

² Cf. *Garey v. St. Joe Mining Co.* (Utah), 91 Pac. 369. ⁵ *New Orleans, etc. R. R. Co. v. Frank*, 39 La. Ann. 707; 2 So. 310.

³ *Humphreys v. Mooney*, 5 Colo. 282, 286-288. ⁶ *Baltimore, etc. Tel. Co. v. Morgan's, etc. Co.*, 37 La. Ann. 883.

⁴ As to a requirement that the paper must show that a certain amount has already been paid on ⁷ *Belfast, etc. Plank Road Co. v. Chamberlain*, 32 N. Y. 651, 654-655, per Brown, J.

lished and the name as given in the incorporation paper will justify a refusal to approve or register the instrument.¹ On the other hand, where a statute requires the consent of municipal authorities to the incorporation of a water-works company, the consent need not mention the precise corporate name stated in the incorporation paper:² the consent required is a consent to the formation of the corporation by the persons who sign the instrument and not a consent to the adoption of the proposed corporate name. The matter of corporate names is the subject of a separate chapter.³

§ 118. **Indebtedness Clause.**—Some incorporation laws require that every incorporation paper shall fix the highest amount of indebtedness to which the company is at any time to be subject.⁴ Such a provision is mandatory, and a failure to comply therewith is a substantial defect.⁵ It has been held that such a provision is complied with by stating that the amount of the company's indebtedness shall not exceed a certain named sum "except by a majority vote of the stockholders present at a called or annual meeting."⁶ The court said that the paper did fix the maximum amount of indebtedness, and that the provision of a method by which that maximum might be increased did not alter this fact; but this reasoning is far from satisfactory, since the provision in question amounts to no more than a provision that the company shall not incur indebtedness in excess of the amount named unless it chooses to do so. A statute forbidding the borrowing of money in excess of "one half of the par value of the capital stock" has been held to refer to the paid-up capital rather than to the authorized capital;⁷ and

¹ *St. Ladislaus, etc. Ass'n*, 19 Pa. Co. Ct. Rep. 25.

² *Kemble v. Milville*, 69 N. J. Law 637; 56 Atl. 311.

³ *Infra*, Chapter VIII.

⁴ As to the power of corporations to borrow where the incorporation paper is not required to and does not contain any provision on the subject, see *supra*, § 69.

⁵ *Heuer v. Carmichael*, 82 Iowa 288; 47 N. W. 1034 (holding that non-compliance renders shareholders liable under a statute subjecting their individual property to the

debts of the company in case of failure to "comply substantially" with the statute).

⁶ *Thornton v. Balcom*, 85 Iowa 198; 52 N. W. 190.

Cf. *Park v. Zwart*, 92 Iowa 37; 60 N. W. 220.

⁷ *Commonwealth v. Lehigh Ave. Ry. Co.*, 129 Pa. St. 405; 18 Atl. 414, 498; 5 L. R. A. 367.

As to what is to be taken as the amount of the capital within the meaning of such provisions limiting the amount of authorized indebtedness, see further, *Poole v. West Point*

the court which pronounced that decision would doubtless construe a similar provision in an incorporation paper in the same way. A provision that the company shall not become indebted to an amount exceeding its capital stock except upon debts of a certain character will not prevent the company from borrowing to the amount of its capital irrespective of the amount for which it may have become indebted for debts of the excepted class.¹

A clause in an incorporation paper limiting the amount of indebtedness which the company may incur would seem to be mandatory and not directory merely.² Consequently, to incur any indebtedness in excess of the limit is *ultra vires*. In England, the indebtedness in excess of the limit would perhaps be void,³ whereas in the United States after the *ultra vires* contract is fully executed on one side by the advance of the money, the company would be liable for the amount of the loan either on the express contract or *quasi ex contractu*.⁴

Butter, etc. Co., 30 Fed. 513; *Cunningham v. German Ins. Bank*, 101 Fed. 977; 41 C. C. A. 609; *Farmers' L. & T. Co. v. Toledo, etc. Ry. Co.*, 67 Fed. 49, 56-58.

¹ *Weber v. Spokane Nat. Bank*, 64 Fed. 208 (construing U. S. Rev. Stats., § 5202, as to national banks).

² *Bell & Coggeshall Co. v. Ky. Glass Works Co. (Ky.)*, 50 S. W. 2; 20 Ky. Law Rep. 1684; *First Nat. Bank v. D. Kieffer Co.*, 95 Ky. 97; 23 S. W. 675; *Wenlock v. River Dee Co.*, 10 A. C. 354 (construing a special act).

But cf. *Weber v. Spokane Nat. Bank*, 64 Fed. 208 (stated infra, § 1070); *Sherman Center Town Co. v. Morris*, 43 Kan. 282; 23 Pac. 569; 19 Am. St. Rep. 134 (declaring that where statute does not require the incorporation paper to fix a limit to the indebtedness to be incurred by the company a clause naming such a limit has no more force than a by-law and is merely directory); *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295 (statute limiting indebtedness declared to be directory).

For a method of evading a

limitation on the amount of authorized indebtedness, see supra, § 70.

³ See infra, § 1031.

But as to the rights of a *bona fide* purchaser of a negotiable instrument without knowledge that the limit had been exceeded, see *Gordon v. Sea Fire Life Ass. Soc.*, 1 H. & N. 599, and infra, § 1705.

⁴ *Sioux City Terminal, etc. Co. of North America*, 82 Fed. 124; 27 C. C. A. 73; *Garrett v. Burlington Plow Co.*, 70 Iowa 697; 29 N. W. 395; 59 Am. Rep. 461 (where the creditor was a director); *Warfield v. Marshall County Canning Co.*, 72 Iowa 666; 34 N. W. 467; 2 Am. St. Rep. 263 (creditor a director); *Beach v. Wakefield*, 107 Iowa 567; 76 N. W. 688; 78 N. W. 197 (applying the same rule to debts secured by mortgage contracted by a railway company in excess of a statutory limit); *Union Trust Co. v. Mercantile Library Hall Co.*, 189 Pa. St. 263; 42 Atl. 129.

Cf. *Poole v. West Point Butter, etc. Ass'n*, 30 Fed. 513; *Vanderveer v. Asbury Park, etc. Ry. Co.*, 82 Fed. 355; *Kraniger v. People's Bldg.*

§ 119. **Effect of Failure to state all Particulars required by Law.** — All the legal requirements must be complied with. If any of the matters required by the statute to be stated is omitted, the instrument is fatally defective;¹ and even if the attempt to incorporate be not wholly void, the company will be at best a *de facto* corporation. Thus, where a statute provides that an incorporation paper shall prescribe regulations for transfers of shares, the instrument should not attempt to delegate to the directors the power to enact regulations or by-laws on that subject.² The only room for difference of opinion is upon the question whether a given provision of the incorporation law in respect to the contents of the incorporation paper is mandatory or directory, and upon the question whether a failure to comply with some mandatory requirement is such a serious defect as to prevent the company from attaining the status of a *de facto* corporation.³

Soc., 60 Minn. 94; 61 N. W. 904 (holding that a loan which extends beyond the limit is valid up to the limit but is void as to the excess where the money was not applied for the company's benefit); *Bell & Coggeshall Co. v. Ky. Glass Works Co.* (Ky.), 50 S. W. 2; 20 Ky. Law Rep. 1684 (holding that a claim which exceeds the amount of the limit is valid up to the limit but void beyond as regards other creditors who contracted their claims without notice that the limit had been exceeded); *First Nat. Bank v. D. Kieffer Milling Co.*, 95 Ky. 97; 23 S. W. 675 (similar to last case); *Humphrey v. Patrons' Mercantile Ass'n*, 50 Iowa 607 (holding that the company is liable for the excess "at least to the extent of the consideration received"); *Connecticut River Sav. Bank v. Fiske*, 60 N. H. 363 (where the court said it was immaterial whether or not the loan was *ultra vires*); *International Trust Co. v. Davis, etc. Mfg. Co.*, 46 Atl. 1054; 70 N. H. 118 (holding that where a mortgage is

executed to secure an issue of bonds the aggregate of which exceeds the limit, bonds issued before the limit is reached are well secured); *Auerbach v. Le Sueur Mill Co.*, 28 Minn. 291; 9 N. W. 799; 41 Am. Rep. 285 (note issued for loan in excess of limit fixed by incorporation paper valid in hands of *bona fide* purchaser); *Wood v. Corry Water Works Co.*, 44 Fed. 146 (*bona fide* purchasers entitled to enforce bonds issued in excess of two thirds of capital paid in).

See also *infra*, § 1705, as to negotiable instruments issued in excess of the limit.

¹ *Williams v. Hewitt*, 47 La. Ann. 1076.

² *Bank of Attica v. Manufacturers, etc. Bank*, 20 N. Y. 501.

³ See *infra*, § 289, and the present chapter *passim*.

Cf. *Cayuga Lake R. R. Co. v. Kyle*, 64 N. Y. 185 (company held a corporation *de facto* notwithstanding indefiniteness in stating location of proposed railway).

§ 120-§ 122. *Insertion of Provisions in Addition to those required by Law.*

§ 120. **Right to insert Additional Provisions.** — The law should not prohibit the insertion in an incorporation paper of other provisions over and above the matters required to be stated; for the instrument is not merely a statutory form but is also an agreement like articles of partnership. That such additional provisions may be inserted in the incorporation paper and when inserted therein become part of the company's fundamental constitution, is settled, in England at least. Hence, any additional provisions so inserted, although not required to be stated, cannot be altered except in the mode, if any, provided for altering the essential parts of the instrument,¹ unless indeed the incorporation paper itself authorizes alterations of these additional provisions.² Although there is no reason why the privilege of inserting in the company's incorporation paper and embedding in its constitution particulars that are not required by law to be stated in the instrument should not be held to exist in America³ as well as in England, yet the privilege, even when expressly conferred by statute (as is sometimes the case) is not

¹ *Ashbury v. Watson*, 30 Ch. D. 376 (headnote inadequate, — overruling dicta in *Guinness v. Land Corporation*, 22 Ch. D. 349, 364, 377, and *Winstone's Case*, 12 Ch. D. 239, 251, and distinguishing *Duke's Case*, 1 Ch. D. 620); *Stevedore's Beneficial Ass'n*, 14 Phila. (Pa.) 130 (semble).

But see *Oban & Aultmore-Glenlivet Distilleries*, 5 Fraser (Sc.) 1140.

² *Underwood v. London Music Hall* (1901), 2 Ch. 309; *Welsbach Incandescent Gas Light Co.* (1904), 1 Ch. 87.

Cf. *Nelson v. Keith-O'Brien Co.* (Utah), 91 Pac. 30 (stated infra, § 144 note).

³ Cf. *Mohawk Nat. Bank v. Schenectady Bank*, 78 Hun (N. Y.) 90; 28 N. Y. Supp. 1100; *Gibbs v. Long Island Bank*, 83 Hun (N. Y.) 92; 31 N. Y. Supp. 406; *Bent v. Underdown*, 156 Ind. 516; 60 N. E. 307.

But see *Stevedore's Beneficial Ass'n*, 14 Phila. 130; *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593, 595; 54 N. E. 407; *O'Brien v. Cummings*, 13 Mo. App. 197 (holding a clause in an incorporation paper limiting the number of shares which one person might hold of no greater effect than a mere by-law); *Renn v. United States Cement Co.* (Ind.), 73 N. E. 269 (provision purporting to fix number of directors held alterable by a mere by-law).

In *Sherman, etc. Town Co. v. Morris*, 43 Kan. 282; 23 Pac. 569; 19 Am. St. Rep. 134, it was said, *obiter*, that a provision in an incorporation paper fixing a limit to the amount that the company is authorized to borrow has, where the law does not require such limit to be stated, the force of a by-law only. In *Grangers' Life, etc. Ins. Co. v. Kamper*, 73 Ala. 325, 341, it was

very often availed of on this side of the Atlantic. Indeed, American lawyers have scarcely begun to appreciate the scope that is given for legal ingenuity in drawing incorporation papers. By means of this right of adding to the indispensable provisions of these instruments, it may be possible to secure some of the advantages of the elasticity and freedom of regulation that the English system of "articles" or recorded by-laws affords.

§ 121. **Unauthorized as distinguished from Unnecessary Provisions — Effect of inserting.** — Of course, care must be taken that any additional provisions inserted in the incorporation paper over and above the particulars required to be stated shall not be contrary to law. For provisions which are expressly or impliedly prohibited, as distinguished from merely unnecessary provisions, are, if inserted, ineffective. To be sure, even prohibited provisions do not have the effect of invalidating the whole instrument provided all that is required by law to be stated is found therein.¹ *Utile per inutile non vitiatur*. The prohibited provisions are void, but they do not vitiate the rest of the instrument. Thus, where the statute requires the assent of the shareholders to any increase of capital, a provision in the incorporation paper purporting to authorize an increase of capital by the directors alone, although of course itself void, does not prevent the company from being legally incorporated.² So, a provision purporting to limit or diminish the shareholders' legal liability to creditors is simply void.³ Similarly, where the law authorizes incorporation for certain purposes, an incorporation paper which besides specifying those purposes adds others not warranted by law, the company is validly incorporated, but

said that "there is no authority of law for introducing more into it (the incorporation paper), and if more be introduced it is mere surplusage, not adding to or detracting from the force of the declaration." The National Banking Act provides that the incorporation paper of a national bank may in addition to the required particulars contain other provisions for the regulation of its affairs; and it has been held that under this statute provisions in the articles of incorporation regu-

lating transfers of shares are unauthorized; *Bullard v. Bank*, 18 Wall. 589 (headnote inadequate).

¹ See in addition to cases cited below, *Becket v. Uniontown Bldg. Ass'n*, 88 Pa. St. 211; *Albright v. Lafayette, etc. Ass'n*, 102 Pa. St. 411.

² *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546.

Cf. *Grangers' Life, etc. Ins. Co. v. Kamper*, 73 Ala. 325.

³ *Van Pelt v. Gardner*, 54 Nebr. 701; 75 N. W. 874. See also *infra*, § 122.

cannot exercise the additional powers unwarrantably sought to be conferred upon it.¹ It has recently been held in England that where a statute authorizes a reduction of capital, if provided for in the articles or by-laws, a clause in the incorporation paper providing for a reduction does not have the same effect as a similar clause in the articles, but is wholly void.² This decision is technical, and on principle one would have thought that any provision which is permissible and effective if found in the by-laws or articles should be legal and effective if inserted in the incorporation paper or memorandum of association.

If the law requires the paper to be approved by a judge or other public officer, he may withhold his approval if the paper contains any prohibited provisions;³ and, indeed, even a mere registrar charged with ministerial functions may refuse to record an instrument which contains any illegal provi-

¹ *Heck v. McEwen*, 12 Lea (Tenn.) 97; *Shick v. Citizens' Enterprise Co.*, 15 Ind. App. 329; 57 Am. St. Rep. 230 (distinguished in *Williams v. Citizens' Enterprise Co.*, 25 Ind. App. 351, 354; 57 N. E. 581); *Cowell v. Springs Co.*, 100 U. S. 55, 60 (headnote inadequate); *Tennessee, etc. Lighting Co. v. Massey*, 56 S. W. 35 (Tenn.); *Shoun v. Armstrong*, 59 S. W. 790 (Tenn.); *Humphreys v. Mooney*, 5 Colo. 282, 292.

But see *State ex rel. Lederer v. International Investment Co.*, 88 Wisc. 512; 60 N. W. 796; 43 Am. St. Rep. 920 (where the unauthorized object was thought to be the primary purpose and the authorized objects merely subordinate purposes of the incorporation).

Cf. *Bayou Cook, etc. Co. v. Doullat*, 35 So. 729; 111 La. 517; *David Bradley Mfg. Co. v. Chicago, etc. Traction Co.* (Ill.), 82 N. E. 210 (held, that where a corporation is incorporated to operate a "street railway" under a law providing for the incorporation of commercial interurban railways only, the word "street" should be regarded as expunged from the incorporation paper and the company deemed a

commercial railway); *Saunders v. Farmer*, 62 N. H. 572 (held a corporation *de facto*).

Quære, what would be the effect if some of the objects be not merely unauthorized but actually illegal or immoral. Cf. *infra*, Chapter V.

In some cases a clause in an incorporation paper has been thought to constitute, so to speak, color of authority for the exercise of powers therein conferred even though those powers be not authorized by the incorporation law: *Prairie Lodge v. Smith*, 58 Miss. 301 (headnote inadequate); *Carson City Sav. Bank v. Carson City Elevator Co.*, 90 Mich. 550; 51 N. W. 641; 30 Am. St. Rep. 454.

² *Dexine Patent Packing & Rubber Co.*, 88 L. T. 791.

³ *Butchers' Beneficial Ass'n*, 35 Pa. St. 151; *Agudath Hakehiloth*, 18 N. Y. Misc. 717; 42 N. Y. Supp. 985; *Benevolent Society*, 10 Phila. (Pa.) 19; *Woodberry v. Mc Clurg*, 78 Miss. 831; 29 So. 514; *Müller v. Tod*, 67 S. W. 483; 95 Tex. 404; *People v. Rose*, 188 Ill. 268; 59 N. E. 432.

Cf. *Medical College of Philadelphia*, 3 Whart. (Pa.) 445.

sions.¹ But on the other hand the action of a ministerial officer in recording the instrument does not preclude judicial inquiry into the legality of any of its provisions.²

§ 122. **What Provisions are unauthorized.** — The existing authorities do not afford much aid in determining what provisions in an incorporation paper are illegal and void, where a provision is not deemed illegal merely because it is not required. Any provision that is contrary to express or implied statutory regulations of course cannot stand.³ Thus, where the purchase by a corporation of its own shares is deemed to be illegal, a clause in an incorporation paper purporting to authorize the company to purchase its own shares would doubtless be void.⁴ So, a clause purporting to vest in the directors a discretion to declare dividends at any time, whereas a statute requires the dividend days to be fixed, would be void.⁵ A federal judge sitting in Louisiana has held that a provision in an incorporation paper purporting to give the company a lien on its shares for debts owing by the holders is void;⁶ but this decision appears to

¹ *Dancy v. Clark*, 24 App. D. C. 487; *State ex rel. Gorman v. Nichols* (Wash.), 82 Pac. 741; *People ex rel. Barney v. Whalen*, 104 N. Y. Supp. 555; *Rex v. Registrar Joint Stock Companies* (1904), 2 Ir. 634 (where the name of the company contained a false statement); *People ex rel. Blossom v. Nelson*, 46 N. Y. 477 (attempt to form a corporation for business purposes, in addition to the purpose of promoting the temporal interests of others, under a statute for formation of benevolent and charitable corporations); *People ex rel. Barney v. Whalen*, 106 N. Y. Supp. 434.

Cf. *People v. Rose*, 219 Ill. 46; 76 N. E. 42 (where the instrument adopted the same name as an existing company); *State ex rel. Osborne v. Nichols*, 38 Wash. 309; 80 Pac. 462.

² *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268, 22 N. E. 798, 17 Am. St. Rep. 319; 8 L. R. A. 497. Cf. *infra*, § 267.

³ Cf. *People ex rel. Barney v.*

Whalen, 104 N. Y. Supp. 555; *Lincoln Bldg., etc. Ass'n v. Graham*, 7 Nebr. 173 (headnote inadequate — clause purporting to authorize lending at usurious interest).

⁴ *Infra*, § 627. Cf. § 624.

⁵ *Marquand v. Federal Steel Co.*, 95 Fed. 725.

⁶ *New Orleans Nat. Banking Ass'n v. Wiltz*, 10 Fed. 330 (headnote inadequate).

Cf. *O'Brien v. Cummings*, 13 Mo. App. 197; *Lyman v. State Bank of Randolph*, 81 N. Y. App. Div. 367; 80 N. Y. Supp. 901, affirmed short 179 N. Y. 577; 72 N. E. 1145.

The decision in *Third Nat. Bank v. Buffalo German Ins. Co.*, 193 U. S. 581, that a provision in the "articles of association" of a national bank, which perform some of the functions of an incorporation paper, purporting to give the bank a lien on its several shares for debts owing by the respective holders, can be explained by the fact that the national bank act expressly forbids banks to lend on the security of

have been ill considered, and was reached by assimilating an incorporation paper, or so-called charter, to mere by-laws, without adverting to the cardinal distinction between them in that the one is matter of record so that all who deal with the company have constructive notice, while mere by-laws rest *in pais*. Accordingly, the Supreme Court of Iowa in a well-reasoned judgment, while recognizing that where a mere by-law confers upon the corporation a lien upon its shares for debts due from the shareholders, *bona fide* purchasers of a share-certificate are not affected thereby, nevertheless held that a similar provision contained in an incorporation paper creates a lien which is effective against all the world, because everybody has constructive notice of the contents of the incorporation paper.¹ In Indiana, a provision declaring that shares may be issued at a discount has been held effective,² but the opposite result was reached by the Supreme Court of Ohio in a case relating to a West Virginia corporation.³ A Vice-Chancellor of New Jersey has expressed the opinion that a clause in an incorporation paper authorizing the directors to bind the company without a board meeting is void although the New Jersey law expressly authorizes the insertion in an incorporation paper of "any provision creating, defining, limiting and regulating" the powers of directors;⁴ but this expression of opinion, although supported by an elaborate statement of reasons, was not strictly necessary to the decision, and is submitted to be so narrow and unjust that the New Jersey Court of Errors, which is distinguished for breadth and sanity of judgment in matters of corporation law, is unlikely to reach the same conclusion.⁵

their own shares and by the fact — which seems to have had more weight with the court — that Congress, by repealing the express provision in the Act of 1863 for such liens, had indicated a legislative intent that the shares should be alienable without any such restriction.

¹ *Dempster Mfg. Co. v. Down*, 126 Iowa 80 (headnote inadequate); 101 N. W. 735; 106 Am. St. Rep. 340.

² *Bent v. Underdown*, 156 Ind. 516; 60 N. E. 307. Cf. *Street & Co.* 17 Vict. L. R. 717.

³ *Security Trust Co. v. Ford* (Ohio), 79 N. E. 474. Accord: *Twigg v. Thunder Hill Mining Co.*, 3 Brit. Columb. 101.

⁴ *Audenried v. East Coast Milling Co.* (N. J.), 59 Atl. 577.

⁵ Cf. *Bell & Coggeshall Co. v. Ky. Glass Works Co.*, 50 S. W. 2; 20 Ky. Law Rep. 1684 (enforcing a clause in an incorporation paper which vested the management of the company in executive officers who were to act without a meeting).

One of the inferior courts in Pennsylvania has even gone so far as to hold that a provision in an incorporation paper of a social club providing that a member shall have as many votes at elections of officers as he holds shares is void;¹ and this decision is the more remarkable because a similar provision in mere by-laws is by the weight of authority quite valid.² A clause in an incorporation paper vesting the exclusive control of the company in the first directors for a period of years, and providing that until the expiration of that time the shareholders should have no right to vote or hold meetings (except in an advisory capacity), has been held by a federal judge to be valid and not in conflict with statutory provisions for annual and other meetings of shareholders, which provisions were construed to apply only to those companies whose incorporation papers contain no stipulation to the contrary.³ This decision is remarkable among American cases in that it errs, if at all, on the side of a liberal and elastic construction of the law. Accordingly, one is not surprised to find that an Indiana court upon very similar facts has reached a diametrically opposite conclusion.⁴

§ 123. **Incorporation of other Documents into Instrument by Reference.** — By analogy to accepted principles relating to deeds of real estate and similar instruments, an incorporation paper may refer to, and by reference incorporate, any existing recorded paper,⁵ but not an unrecorded document or a document not at the time in existence. Thus, a reference in the incorporation paper to by-laws to be subsequently adopted by the company will not make such by-laws part of the company's recorded

¹ *Commonwealth ex rel. Nickerson v. Conover*, 30 Leg. Int. (Pa.) 200.

² See *infra*, § 1216.

³ *Union Trust Co. v. Carter*, 139 Fed. 717.

⁴ *State ex rel. Ross v. Anderson*, 67 N. E. 207; 31 Ind. App. 34.

⁵ Cf. *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451 (where articles of incorporation consisted of several separate instruments, exact

copies of each other, but each signed by different persons); *Monroe Republican Club*, 6 Pa. Dist. R. 515 (application for charter typewritten upon several sheets of paper joined together with eyelets, instead of being written upon one single sheet, said to be irregular); *Stevedore's Beneficial Ass'n*, 14 Phila. (Pa.) 130 (similar point to last case); *Accountants' Ass'n*, 5 Pa. Dist. Rep. 699 (similar point to last two cases).

constitution nor charge persons who may afterwards deal with the company with notice of their existence and contents.¹

§ 124-§ 131. *Execution of Instrument.*

§ 124. **In general — Signature — Number of Subscribers, etc. —** An incorporation paper must of course be signed; if unsigned, it is a nullity.² Moreover, it must be signed by the number of subscribers required by law. This is an essential point.³ Thus, if the law requires, say, five or more subscribers, a paper signed by three only is invalid.⁴ On the other hand, where the law requires three subscribers, two of the three may be husband and wife;⁵ baron and feme are not nowadays for this purpose regarded as one person. Signature by a mark is sufficient.⁶ *A fortiori*, a subscriber need not sign his full name: a signature designating a subscriber's Christian name by an initial merely is sufficient.⁷ If the statute provide that the places of residence of the subscribers shall be stated, the provision is mandatory: a failure to give the place of residence of each of a number sufficient to perfect the organization cannot be deemed disregard of a mere directory provision.⁸

¹ *Royal Bank of India's Case*, 4 Minn. 303, 310; 73 N. W. 147 Ch. 252.

² *Lawrie v. Silsby* (Vt.), 56 Atl. 1106; 76 Vt. 240; 104 Am. St. Rep. 927; *Unity Ins. Co. v. Cram*, 43 N. H. 636 (explained in *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295, 313).

Cf. *Kaiser v. Lawrence Savings Bank*, 56 Iowa 104 (headnote inadequate); 8 N. W. 772; 41 Am. Rep. 85.

³ See *infra*, § 1084.

⁴ *Helping Hand Marriage Ass'n*, 15 Phila. 644 (headnote inadequate); *Rhoads v. Hoernerstown Bldg., etc. Ass'n*, 82 Pa. St. 180; *Hamilton Road Co. v. Townsend*, 13 Ont. Rep. 534; *People ex rel. Weatherly v. Golden Gate Lodge*, (Cal.), 60 Pac. 865; 128 Cal. 257; *State ex rel. Clapp v. Critchett*, 37 Minn. 13; 32 N. W. 787.

Cf. *Johnson v. Okerstrom*, 70

303, 310; 73 N. W. 147 (paper signed by less than required number of persons held colorable compliance with law sufficient to give rise to incorporation *de facto*); *Duggan v. Colorado Mtge., etc. Co.*, 11 Colo. 113, 117 (headnote inadequate, — holding that forgery of one of the requisite minimum number of signatures is not ground for collateral attack on validity of incorporation).

⁵ *Good Land Co. v. Cole* (Wisc.), 110 N. W. 895.

⁶ *Board of Trustees of Seventh Street, etc. Church v. Campbell*, 48 La. Ann. 1543; 21 So. 184.

⁷ *State ex rel. Collings v. Beck*, 81 Ind. 500.

⁸ *Busenback v. Attica, etc. Gravel Road Co.*, 43 Ind. 265. As to such provisions, see also, *Steinmetz v. Versailles, etc. Turnpike Co.*, 57 Ind.

§ 125. **Sealing of Instrument.** — The instrument need not be under the seals of the subscribers unless the statute so requires; but a provision that the paper shall be under seal cannot be deemed directory merely.¹ As more fully explained below, a provision that the paper “shall bind the company and each member to the same extent as if each member had signed his name and affixed his seal thereto,” does not require the instrument to be sealed by the subscribers.²

§ 126. **Acknowledgment of Instrument.** — A provision that the instrument shall be acknowledged as well as signed is mandatory;³ but a magistrate’s certificate that the paper was “subscribed and sworn to” before him sufficiently shows that it was acknowledged.⁴ Where the instrument is required to be acknowledged before a clerk of court or justice of the peace it is invalid if acknowledged before a notary public,⁵ even though the notary

¹ *Griffin v. Clinton Line, etc. R. R. Co.*, 11 Fed. Cas. 27.

Cf. *Warner v. Callender*, 20 Ohio St. 190.

² *Whitley Partners*, 32 Ch. D. 337. See *infra*, § 131.

³ *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738; 17 S. E. 305; *Doyle v. Mizner*, 42 Mich. 332; 3 N. W. 968; *People ex rel. Long Island R. R. Co. v. Board of R. R. Commrs.*, 75 N. Y. App. Div. 106; 77 N. Y. Supp. 380 (holding acknowledgment by each of the required number of signatories to be requisite); *People v. Montecito Water Co.*, 97 Cal. 276; 32 Pac. 236; 33 Am. St. Rep. 172; *Kaiser v. Lawrence Savings Bank*, 56 Iowa 104 (headnote inadequate); 8 N. W. 772; 41 Am. Rep. 85.

Cf. *Wall v. Mines*, 130 Cal. 27; 62 Pac. 386 (provision for verification by affidavit held mandatory); *First Nat. Bank v. Rockefeller*, 195 Mo. 15 (headnote misleading); 93 S. W. 761; *Duggan v. Colorado Mortgage, etc. Co.*, 11 Colo. 113; 17 Pac. 105 (lack of acknowledgment held not to prevent such colorable compliance with law as to give rise to a corporation *de facto*

— headnote inadequate); *Dannebroke Gold, etc. Co. v. Allment*, 26 Cal. 286 (acknowledgment by one of subscribers by attorney held, not ground for collateral attack on validity of incorporation where a statute forbade such attack if the company claims in good faith to be a corporation); *Franke v. Mann*, 106 Wisc. 118; 81 N. W. 1014; 48 L. R. A. 856 (lack of acknowledgment no bar to incorporation *de facto*); *Stout v. Zulick*, 48 N. J. Law 599 (headnote inadequate); 7 Atl. 362 (formal defect in certificate of acknowledgment no bar to incorporation *de facto*); *Central Agricultural, etc. Ass’n, v. Ala. Gold Life Ins. Co.*, 70 Ala. 120 (lack of acknowledgment not fatal to corporate existence *de facto*).

As to the conclusiveness of a magistrate’s certificate of acknowledgment, see *infra*, § 283.

⁴ *Cuykendall v. Douglas*, 19 Hun (N. Y.) 577.

⁵ *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123; 28 S. W. 668; 45 Am. St. Rep. 700; 26 L. R. A. 509.

Cf. *First Baptist Soc. v. Rapalee*, 16 Wend. (N. Y.) 605 (acknowledg-

is by another statute authorized in general terms to take acknowledgments of all written instruments.¹ An acknowledgment taken by one of the subscribers of the paper in his capacity as notary is void.² The officer taking the acknowledgment need not certify that the persons who acknowledged the instrument are personally known to him unless such is the express requirement of the statute, even though as to acknowledgments of deeds of real estate such a certificate is required.³ And, of course, a provision that the paper shall be "subscribed by five or more persons . . . and acknowledged by each" is not satisfied by a paper signed by five persons but acknowledged by four of them only.⁴

§ 127. **Place of Execution.** — An incorporation paper may be both subscribed and acknowledged in a foreign state.⁵

§ 128. **Execution of Duplicate Instruments.** — The New York Court of Appeals in 1857 decided that "articles of association" might consist of several distinct papers, exact copies or transcripts of each other with the exception of the signatures;⁶ but this case can hardly be relied upon as approving such a practice under modern incorporation laws, unless each of the duplicates is signed by the requisite minimum number of subscribers.

§ 129. **Execution and Delivery in Escrow.** — It has been held that an incorporation paper cannot be executed and delivered in escrow. That is to say, if such a paper is signed and delivered to some person with the understanding that it shall not be used

ment before commissioner of deeds ineffective when statute requires acknowledgment before a judge, — a decision which is criticised in *Buffalo, etc. R. R. Co. v. Cary*, 26 N. Y. 75, 78, as overlooking the distinction between incorporation *de jure* and *de facto*; *Hagerman v. Ohio Bldg., etc. Ass'n* 25 Ohio St. 186, 200-201 (acknowledgment before notary instead of justice of the peace not ground for collateral attack on corporate existence).

¹ *State ex rel. Attorney-General v. Lee*, 21 Ohio St. 662.

² *People ex rel. Erie R. R. Co. v. Board of Railroad Commissioners*, 105 N. Y. App. Div. 273; 93 N. Y. Supp. 584.

³ *People ex rel. Bernard v. Cheeseman*, 7 Colo. 376; 3 Pac. 716; *Johnston v. Ewing Female University*, 35 Ill. 518.

⁴ *People v. Montecito Water Co.*, 97 Cal. 276; 32 Pac. 236; 33 Am. St. Rep. 172.

⁵ *Humphreys v. Mooney*, 5 Colo. 282, 293.

Cf. *Re Charter Acknowledgments*, 28 Pa. Co. Ct. Rep. 187 (Op. of Atty.-Gen.); *Dooley v. Cheshire Glass Co.*, 15 Gray (Mass.) 494.

⁶ *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451.

Cf. *Sodus Bay, etc. R. R. Co. v. Hamlin*, 24 Hun (N. Y.) 390.

the instrument was signed personally by seven other persons — the minimum number prescribed by the statute — so that in strictness the only question before the court was whether the signature by attorney was a binding subscription to the number of shares written after the name; for even if the doubtful signature had been rejected, the instrument being still signed by the requisite number of persons, the incorporation would have been valid. New York Court of Appeals has gone even further and held that some of the minimum number of subscribers required by the statute may sign by attorney and that the authority of the agent, although not apparent of record, will be presumed.¹ Statutes sometimes provide that the instrument shall be executed and acknowledged like a deed of real estate; and in that case, of course, no execution by proxy could avail unless the power of attorney were under seal and recorded. But a provision that the instrument shall “bind the company and each member to the same extent as if each member had signed his name and affixed his seal thereto”² does not require the subscribers to seal the paper and does not make the instrument a deed so as to require a power of attorney to execute it to be under seal.³

§ 132. **Function of Subscribers as Shareholders or otherwise.** — The English Companies Act and most of the more modern American incorporation laws require each subscriber to every incorporation paper to subscribe for at least one share, writing after his name the number of shares he takes.⁴ But if there be no such affirmative requirement — and this was the case with many

¹ *New York, Lackawanna, etc. Ry. Co.*, 99 N. Y. 12; 1 N. E. 27.

² Companies Act, 1862, § 11.

³ *Whitley Partners*, 32 Ch. D. 337.

⁴ Where an incorporation paper is signed by three persons and contains a statement that the stock is to be “divided half-and-half between the parties,” each subscriber takes one-third of the shares. *Bates v. Wilson, etc. Co.*, 14 Colo. 140; 24 Pac. 99.

For a full statement of the law respecting subscriptions to shares by signing the incorporation paper of a company, see *infra*, § 238—§ 248.

In *Valk v. Crandall*, 1 Sandf. Ch. (N. Y.) 179, where the statute required the incorporation paper to be signed by the shareholders, an instrument signed by the directors and giving the names of other shareholders, but not signed by them, was held invalid.

of the earlier American statutes, some of which are still in force — the signatories of the incorporation paper were not necessarily shareholders.¹ Their functions and powers are the subject of detailed consideration below.²

§ 133-§ 137. *Registration of Instrument.*

§ 133. **Necessity for Registration.** — The registration of the incorporation paper is a matter of the utmost importance. By means of the registry, the public is informed, constructively if not actually, of the objects of the company, of the amount of its nominal capital, and of the other particulars respecting the enterprise required by law to be stated. Hence, without registration in the office of the proper official or registrar, the company cannot be deemed incorporated even *de facto*.³ It has

¹ *Coyote, etc. Co. v. Ruble*, 8 Oreg. 284; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 54; *Singer Mfg. Co. v. Peck*, 9 S. Dak. 29; 67 N. W. 947; *Bristol, etc. Trust Co. v. Jonesboro, etc. Trust Co.*, 101 Tenn. 545; 48 S. W. 228.

But see *Dancy v. Clark*, 24 App. D. C. 487, 507-509 (where the subscribers of the incorporation paper were declared to be shareholders from the incorporation of the company, although apparently no statute made them such).

² *Infra*, § 165-§ 167.

³ *Lusk v. Riggs*, 97 N. W. 1033; 70 Nebr. 713; *Abbott v. Omaha Smelting Co.*, 4 Nebr. 416; *Field v. Cooks*, 16 La. Ann. 153; *Bigelow v. Gregory*, 73 Ill. 197; *Childs v. Hurd*, 32 W. Va. 66; 9 S. E. 362; *Brad-dock Boro' v. Penn Water Co.*, 189 Pa. St. 379; 42 Atl. 15; *Elgin Nat. Watch Co. v. Loveland*, 132 Fed. 41; *Goodale Lumber Co. v. Shaw*, 41 Oreg. 544; 69 Pac. 546; *Bergeron v. Hobbs*, 96 Wisc. 641; 71 N. W. 1056; 65 Am. St. Rep. 85; *Guckert v. Hacke*, 159 Pa. St. 303; 28 Atl. 249 (attempted to be distinguished in *Pinkerton v. Pa. Traction Co.*, 193 Pa. 229); *Garnett v. Richardson*, 35 Ark. 144; *Hurt v. Salisbury*, 55

Mo. 310; *Cresswell v. Oberly*, 17 Ill. App. 281 (semble).

But see *Vanneman v. Young*, 52 N. J. Law 403; 20 Atl. 53 (where a statute providing that upon registration of the instrument the company should be incorporated from the date mentioned in the paper for the commencement of corporate existence seems to have been construed to make the corporate existence upon recording relate back to the date mentioned in the instrument, where the registration was delayed until a later date); *Pinkerton v. Pa. Traction Co.*, 193 Pa. St. 229; 44 Atl. 284; *Merrick v. Reynolds Engine, etc. Co.*, 101 Mass. 381 (where statute provided for articles of agreement which were not required to be recorded, and for the execution of a certificate by the officers, which should state the purposes of the company, etc., and was required to be recorded, the execution and record of the certificate were held to be conditions subsequent rather than precedent to incorporation); *Harrod v. Hamer*, 32 Wisc. 162 (same point as that of last case).

As to the effect of recording the paper surreptitiously, without the authority of the subscribers, see *Ricker v. Larkin*, 27 Ill. App. 625.

been said that the execution of an incorporation paper is analogous to the execution of a deed of real estate, and that the instrument is devoid of legal effect until registration, which is the equivalent of delivery.¹

§ 134. **What must be registered — Copy or Original.** — If the statute requires a copy of the instrument, verified by the affidavit of two or more subscribers, to be recorded, it has been held that the law is not satisfied by the recording of the original instrument,² although the court seems to have thought that the recording of the original paper might form such colorable compliance with the statute as to give rise to a corporation *de facto*. If the statute, as is usually the case, requires registration of the original, there might be a difficult question whether registration of a copy would amount even to colorable compliance with law.

§ 135. **What amounts to Registration.** — The essential element in recording is the act of depositing the paper with the proper officer.³ An averment in a pleading that an incorporation paper had not been filed with the recorder is a sufficient allegation that it had not been recorded;⁴ and, conversely, an allegation that it had been recorded necessarily implies that it was filed.⁵ Consequently, an error of the registrar in endorsing

¹ *Humphreys v. Mooney*, 5 Colo. 282, 293.

² *Slocum v. Head*, 105 Wisc. 431; 81 N. W. 673; 50 L. R. A. 324.

³ See *San Diego Gas Co. v. Frame*, 137 Cal. 441; 70 Pac. 295; *Pittston Engine, etc. Co.*, 11 Pa. Co. Ct. Rep. 182.

But cf. *Byronville Creamery Ass'n v. Ivers*, 100 N. W. 387; 93 Minn. 8 (where the paper was duly filed for record but was never actually recorded); *Johnson v. Okerstrom*, 70 Minn. 303, 310; 73 N. W. 147 (semble, similar point to that of last case).

See also *State ex rel. O'Brien v. Bethlehem, etc. Gravel Road Co.*, 32 Ind. 357 (holding an allegation that the paper had not been filed "with the recorder," not to be a sufficient averment that it had not been filed in his office, *sed quære*); *Bushnell v. Consolidated Ice Machine Co.*, 138

Ill. 67, 73 (headnote inadequate) 27 N. E. 596 (holding an allegation that a certificate of incorporation had not been recorded to be an insufficient denial of incorporation, as the instrument might have been filed for record and not actually recorded).

⁴ *Wood v. Union Gospel Church Bldg. Ass'n*, 63 Wisc. 9; 22 N. W. 756.

⁵ *Vawter v. Franklin College*, 53 Ind. 88.

But see *Bergeron v. Hobbs*, 96 Wisc. 641; 71 N. W. 1056; 65 Am. St. Rep. 85 (holding that to leave the paper with the registrar temporarily for the purpose of being recorded and then withdrawn is not compliance with a statute requiring it to be filed); *Bushnell v. Consolidated Ice Machine Co.*, 138 Ill. 67, 73; 27 N. N. 596 (stated *supra*, note 3).

upon the paper an incorrect date as the date of filing in no respect affects the validity of the incorporation;¹ and the same is true of an error in recording the paper in a wrong book.²

§ 136. **Powers and duties of Registrar.** — The registrar may refuse to record a paper which on its face complies with law if he has independent knowledge, or finds from extraneous evidence that some of the requirements of law have not in fact been complied with — for example, if some of the subscribers required by law to be citizens are in fact non-residents,³ *a fortiori*, the registrar may refuse to record any paper which on its face is irregular, for example, if the instrument contain in addition to the matters required by law further and illegal provisions.⁴ Although the registrar may and indeed should examine an instrument offered for record and if it fail to comply with law refuse to receive it,⁵ yet if his determination in that regard be erroneous, he may be compelled by mandamus to register it.⁶ The effect of an erroneous determination by the registrar, or by any other official to whom the instrument is submitted, that the paper is entitled to record is considered below.⁷

§ 137. **Registration in more than one Office.** — Sometimes the instrument, or a duplicate or copy, is required to be registered in several different offices, e. g., in the office of a county clerk, and in the office of the secretary of state. In such cases, refer-

¹ *State ex rel. Padgett v. Foulkes*, 94 Ind. 493, 496.

² *San Diego Gas Co. v. Frame*, 137 Cal. 441; 70 Pac. 295; *Walton v. Riley*, 85 Ky. 413; 3 S. W. 605.

³ *American Salt Co. v. Heidenheimer*, 80 Tex. 344, 347; 15 S. W. 1038; 26 Am. St. Rep. 743 (semble).

But see *State ex rel. Home Bldg., etc. Ass'n v. Rotwitt*, 17 Mont. 537; 43 Pac. 922 (holding that the registrar is confined to the face of the paper and cannot go into the motives of the subscribers).

As to refusal to record an instrument because the proposed corporate name is unduly similar to that of another corporation, see *People ex rel. Felter v. Rose*, 80 N. E. 293; 225 Ill. 496. See also *infra*, § 449.

⁴ See *supra*, § 121.

⁵ *People ex rel. Davenport v. Rice*, 68 Hun (N. Y.) 24; 22 N. Y. Supp. 631 (approval of paper by a judge to whom a statute required it to be submitted held not to be conclusive on the registrar); *People ex rel. Blossom v. Nelson*, 46 N. Y. 477.

⁶ *American Salt Co. v. Heidenheimer*, 80 Tex. 344, 347; 15 S. W. 1038; 26 Am. St. Rep. 743 (semble); *People ex rel. U. S. Grand Lodge v. Payn*, 161 N. Y. 229; 55 N. E. 849; *McChesney v. Batman* (Ky.), 89 S. W. 198; *State v. Taylor*, 55 Ohio St. 61; 44 N. E. 513.

Cf. *State ex rel. Hutchinson v. McGrath*, 92 Mo. 355; 5 S. W. 29, *Illinois Watch Case Co. v. Pearson*; 140 Ill. 423; 31 N. E. 400; 16 L. R. A. 429.

⁷ § 266-§ 270.

ence must be had to the terms of the particular statute in question in order to determine the relative importance of the filing with the local officer and the filing with the state officer.

For example, under some statutes, the most important point is the filing of the instrument with the state officer, and the statutory provision for filing a duplicate or copy with a county officer is construed as directory merely, or at any rate non-compliance therewith is regarded as a breach of condition subsequent to be availed of only by the state on direct proceedings to declare the corporate existence forfeited¹ or as a mere irregularity which when the company goes into operation as a corporation *de facto* will not justify a collateral attack on its existence.² Under such statutes, the corporation never comes into existence even *de facto* where the instrument is recorded in the county office but not with the state officer.³

On the other hand, the terms of the statute may show that the all-important step is the filing of the instrument with the county officer⁴ and that the provision for filing a duplicate or copy with the state officer is directory merely,⁵ or a condition subsequent to incorporation,⁶ or a requirement such that disregard of it will not prevent the company from becoming a corporation *de facto*.⁷ Under such statutes the fact that the instrument is recorded in the wrong county is a serious irregularity and prevents the company from becoming a corporation *de jure* even though a copy is duly filed with the secretary of state, a copy of whose certificate

¹ *Jhons v. People*, 25 Mich. 499.

² *Bushnell v. Consolidated Ice Machine Co.*, 138 Ill. 67, 73; 27 N. E. 596; *Curtis v. Meeker*, 62 Ill. App. 49 (with which compare *Loverin v. McLaughlin*, 161 Ill. 417; 44 N. E. 99); *Humphreys v. Mooney*, 5 Colo. 282, 295.

³ *Card v. Moore*, 68 N. Y. App. Div. 327; 74 N. Y. Supp. 18, affirmed short, 173 N. Y. 598 (relating to the law of Connecticut).

⁴ *Childs v. Hurd*, 32 W. Va. 66; 9 S. E. 362 (relating to law of N. Y.)

⁵ *Garnett v. Richardson*, 35 Ark. 144 (headnote inadequate); *Cross v. Pinckneyville Mill Co.*, 17 Ill. 54, 56.

Cf. *Bartlett v. Wilbur*, 53 Md. 485 (relating to law of New York).

⁶ *First Nat. Bank v. Davies*, 43

Iowa 424; *Mokelumne Hill Mining Co. v. Woodbury*, 14 Cal. 424; 73 Am. Dec. 658; *Portland, etc. Turnpike Co. v. Bobb*, 88 Ky. 226; 10 S. W. 794; *Rassbeck v. Desterreicher*, 55 How. Pr. (N. Y.) 516; 4 Abb. N. C. 444; *Walton v. Riley*, 85 Ky. 413; 3 S. W. 605.

⁷ *Hyde v. Doe*, 4 Sawy. 133; *Vanneman v. Young*, 52 N. J. Law 403; 20 Atl. 53; *Grand River Bridge Co. v. Rollins*, 13 Colo. App. 4; 21 Pac. 897; *Tarbell v. Page*, 24 Ill. 46; *Leonardsville Bank v. Willard*, 25 N. Y. 574; *Central Agricultural, etc. Ass'n v. Ala. Gold Life Ins. Co.*, 70 Ala. 120 (headnote inadequate).

of incorporation is recorded in the county where the original incorporation paper ought to have been recorded.¹

Still other statutes have been construed to make both the filing with the county officer and with the state officer of equal importance and both indispensable to the creation of even a *de facto* corporation.² Even under such statutes, if the instrument is duly filed with the secretary of state, the fact that a certified copy of the incorporation paper, or even the secretary of state's certificate of incorporation, instead of a duplicate original of the incorporation paper, is recorded in the county office, is not deemed so serious an irregularity as to prevent the company from becoming a *de facto* corporation.³

Of course, where the instrument is duly registered both in the county office and in the state office, failure to observe a statutory requirement for registration in any other county in which the company may transact business can be no more than a cause of forfeiture of corporate existence.⁴

§ 138. **Publication in Newspaper.** — Publication of the incorporation paper, or of extracts or abstracts thereof, in some newspaper is sometimes required, and performs somewhat the same function as the registration of the instrument.⁵ Nevertheless, such publication even when required has been held not to be a condition precedent to incorporation.⁶

¹ *Martin v. Deetz*, 102 Cal. 55; 36 Pac. 368; 41 Am. St. Rep. 151 (note that the court conceded that if the company had transacted business as a corporation it would have been a corporation *de facto*).

² *Indianapolis, etc. Co. v. Herkimer*, 46 Ind. 142; *Brewer v. State*, 7 Lea (Tenn.) 682; *Lusk v. Riggs*, 97 N. W. 1033; 70 Nebr. 713; *Sims v. Commonwealth*, 71 S.W. 929; 114 Ky. 827; *Hurt v. Salisbury*, 55 Mo. 310.

Cf. *Loverin v. McLaughlin*, 161 Ill. 417; 44 N. E. 99.

³ *Huntington Mfg. Co. v. Schofield*, 62 N. E. 106; 28 Ind. App. 95; *Williamson v. Kokomo Bldg., etc. Ass'n*, 89 Ind. 389.

⁴ *Anderson v. Railroad*, 91 Tenn. 44; 17 S. W. 803.

Cf. *Young Reversible Lock-Nut Co. v. Young Lock-Nut Co.*, 72 Fed. 62 (as to a New York statute).

⁵ See *Church of the Holy Communion*, 14 Phila. 121; *Seaton v. Grimm*, 110 Iowa 145; 81 N. W. 225; *Sweney Bros. v. Talcott*, 85 Iowa 103, 110; 52 N. W. 106.

⁶ *Holmes v. Gilliland*, 41 Barb. (N. Y.) 568; *Walton v. Riley*, 85 Ky. 413; 3 S. W. 605.

Cf. *Wood v. Wiley Construction Co.*, 56 Conn. 87, 97-98; 13 Atl. 137; *Dooley v. Cheshire Glass Co.*, 15 Gray (Mass.) 494, *Harrod v. Hamer*, 32 Wisc. 162.

§ 139-§ 142. *Submission of Instrument to Public Officer for Approval.*

§ 139. **Examination of Instrument by Registrar when paper filed for Record.** — General incorporation acts often provide that each incorporation paper must be submitted to some public official for his approval. As we have seen, a mere registrar charged with the duty of recording the instrument may refuse to receive for record a paper which does not comply with the statutory requirements;¹ and thus he may be said to be in a certain sense invested with the duty of passing upon and approving the instrument. But under statutes of this class, the officer's approval is a mere incident in, or part of, the registration, and does not constitute a distinct step in the process of incorporation.

§ 140. **Submission to some other Officer before filing for Record.** — Other statutes provide that every incorporation paper, before it is filed for record with the registrar, must be submitted to a judge or to some administrative official and be indorsed with a certificate of his approval.² Under statutes of this class, the approval of the judge is a preliminary to registration. Although the indorsement of approval by the court or officer does not preclude the registrar from refusing to record the paper if he find upon inspection that it does not comply with the law,³ nevertheless he ought not to record any instrument offered for registration unless it bear the official indorsement of approval. If he do so, the incorporation would seem to be irregular even though the instrument may in fact in all its terms comply with law. Perhaps, however, the irregularity would not be deemed such as to prevent the company from attaining a *de facto* existence.⁴

But see *Bigelow v. Gregory*, 73 Ill. 197; *Clegg v. Hamilton, etc. Co.*, 61 Iowa 121; 15 N. W. 865; *Heinig v. Adams, etc. Mfg. Co.*, 81 Ky. 300 (overruled); *Eisfeld v. Kenworth*, 50 Iowa 389; *Unity Ins. Co. v. Cram*, 43 N. H. 636.

As to what is a newspaper "as convenient as practicable to the principal place of business," see *Clinton Novelty Iron Works v. Neit-*

ing (Iowa) 111 N. W. 974; *Berkson, Hughes & Co. v. Anderson*, 115 Iowa 674; 87 N. W. 402.

¹ *Supra*, § 138.

² Cf. *Richmond Factory Ass'n v. Clarke*, 61 Me. 351.

³ *People ex rel. Davenport v. Rice*, 68 Hun (N. Y.) 24; 22 N. Y. Supp. 631.

⁴ As to the effect of fraud in procuring the approval, see *infra*, § 267.

§ 141. **Submission by way of Petition to Officer for Issue of Charter.** — Still other statutes provide that the incorporation paper shall be in the nature of a petition addressed to a court, or to the governor of the state or other executive officer; and that thereupon the court or official to whom the petition is addressed shall, if he find that the same complies with law, issue a “charter” or “certificate of incorporation” incorporating the applicants according to the prayer of the petition. Under statutes of this class, the submission of the petition or incorporation paper to the judge or other officer is an integral and essential part of the incorporation, and without such submission and approval there can be no corporation at all — not even a corporation *de facto*.¹ The application for issue of the “charter” or decree of incorporation is an *ex parte* proceeding, and no third person has any right to intervene and object to the granting of the application.² Under some such statutes, the officer to whom the application is addressed is invested with a considerable degree of discretion, and may, for example, refuse an application where the proposed corporate name is likely to cause confusion even though it do not amount to an infringement of any legal rights.³

§ 142. **Issue of Certificate of Approval after Registration.** — Still other statutes, for example, the English Companies Act of 1862, provide that after the instrument has been recorded, the registrar or some other official shall issue a certificate stating that the instrument has been recorded and that the company is incorporated. If the language of the statute show that the incorporation is to date from the approval by the registrar, or other public official, and the issue of his certificate, there can be no corporation — not even a corporation *de facto* — until such approval be secured and the certificate issued.⁴ But in the

¹ As to the effect of fraud in procuring the official approval, and the question whether the officer may revoke his approval, see *infra*, § 267.

² *Young Women's Christian Ass'n v. St. Louis Women's Christian Ass'n*, 115 Mo. App. 228; 91 S. W. 171.

But cf. *Polish Nat. Catholic Church*, 31 Pa. Super. Ct. 87 (where the opponents to the granting of the

charter were heard); *Bradley Fertilizer Co.*, 19 Pa. Co. Ct. 271.

³ *Polish Nat. Cath. Church*, 31 Pa. Super. Ct. 87; *Philadelphia Lying-in Charity v. Maternity Hospital*, 29 Pa. Super. Ct. 420.

⁴ Cf. *Stowe v. Flagg*, 72 Ill. 397; *First Nat. Bank v. Rockefeller*, 195 Mo. 15, 41-42 (semble); 93 S. W. 761; *Sexton v. Snyder*, 119 Mo. App. 668 (headnote inadequate); 94 S. W. 562.

absence of an explicit provision making the issue of the certificate a condition precedent to incorporation — and *a fortiori* where the law provides that the subscribers of the incorporation paper shall be incorporated from the registration of the instrument — the certificate is of only evidentiary value, and is needed only as convenient proof that the law has been complied with.¹ In such cases, the failure to submit the instrument to the proper official, or an omission to secure the certificate of incorporation, is at most a breach of a condition subsequent, to be availed of by the state alone.²

§ 143. **Alteration of Instrument after Execution and before Registration.** — If any material alteration be made in the incorporation paper after its execution and before its registration, without the assent of all the subscribers, the paper in its altered form is certainly not binding upon the parties.³ The effect of recording the document as altered, under statutes making registration conclusive evidence of compliance with law, will be considered hereafter.⁴ Lord Cairns once expressed the opinion that any alteration of this sort would, like a fraudulent alteration in a deed or promissory note, render the whole instrument altogether void, so that it would no longer, in its unaltered form, be binding upon the subscribers.⁵ Although an incorporation paper is not a sealed instrument unless expressly required to be under seal, still Lord Cairns's dictum corresponds with the policy of the law. For whether or not the document is a technical common law specialty, it is certainly a very formal and peculiar instrument, and should, in this respect, for the prevention of frauds, be governed by the same rules as a deed. So, it has been held that where an incorporation paper when signed by one of the subscribers contains material blanks, there is no

¹ *Sparks v. Woodstock Iron, etc. Co.*, 87 Ala. 294, 298; 6 So. 195. *tion v. Rodes*, 37 W. Va. 738; 17 S. E. 305.

² As to the effect of fraud in procuring the certificate, and as to the question whether the officer granting the certificate may revoke his determination, see *infra*, § 267. As to immaterial alterations, see *Union Agricultural, etc. Ass'n v. Neill*, 31 Iowa 95.

⁴ See *infra*, § 268-§ 270.

⁵ *Peel's Case*, 2 Ch. 674, 681.

³ *Greenbrier Industrial Exposi-*

authority without the subsequent consent of that subscriber to fill up the blanks.¹ In Maryland, it was held that where a subscriber to an incorporation paper, which had been materially altered after he had signed, subsequently acknowledged the instrument in ignorance of the alteration, he was not estopped from relying on the alteration as a defense to an action on his agreement to accept and pay for shares in the company;² but this decision goes to the very verge of the law, for where the rights of innocent third parties may accrue on the faith of the acknowledgment, the subscribers should not in general be allowed to plead ignorance of what they were doing. Possibly, in such a case, although the alteration may be a defense to an action upon the subscriber's agreement to take shares, it may not annul the incorporation of the company. Indeed, that seems to have been the view of the Maryland court in the case last cited. It would seem that an incorporation paper may always be altered, with the unanimous consent of the subscribers, at any time before it is recorded.³

§ 144-§ 160. ALTERATION AFTER REGISTRATION.

§ 144. **Alteration after Recording generally impossible without enabling Statute.** — The general scheme of the incorporation laws contemplates that each memorandum of association or incorporation paper shall from the time of registration be the unalterable constitution of the company.⁴ This policy of the law cannot be circumvented by inserting a clause authorizing the company to alter the provisions of the instrument at pleasure; for such a clause would be void as regards any matters required by law to be fixed and determined in the incorporation paper.⁵

¹ *Dutchess, etc. R. R. Co. v. Mabbett*, 58 N. Y. 397. *Co.* (1904), 1 Ch. 87 (semble); *Dexine Patent Packing & Rubber Co.*, 88 L. T.

² *Hughes v. Antietam Mfg. Co.*, 791. 34 Md. 316.

³ Cf. *Gade v. Forest Glen Brick Co.*, 165 Ill. 367; 46 N. E. 286. But see *Thornton v. Balcom*, 85 Iowa 198; 52 N. W. 190 (criticised supra, § 118); *Nelson v. Keith-O'Brien Co.* (Utah), 91 Pac. 30

⁴ Cf. *New York Cable Ry. Co.*, 109 N. Y. 32; 15 N. E. 882 (where an attempt was made to amend an instrument which in its original form was fatally defective). (where, in a rather cloudy opinion, the court appears to hold that under a statute providing that no alteration in the incorporation paper shall change the liability of holders of

⁵ *Welsbach Incandescent Gas Light*

We have seen above that this rule that an incorporation paper cannot be altered applies even to matters not required to be stated in the instrument,¹ except that the paper itself may provide otherwise.² An unauthorized attempt to amend the incorporation paper is void, and of course therefore the corporate existence and power of the company to carry on business under the original instrument is not affected.³

§ 145. **Reformation for Mistake.**—Not even a court of equity has power to rectify a mistake in an incorporation paper after it has been duly recorded. This conclusion was reached in regard to the articles of association of an English company,⁴ and *a fortiori* the same principle would apply to a memorandum of association or incorporation paper. The blunder is, therefore, beyond remedy unless the statute provides some means of altering the instrument.

§ 146. **Historical Outline of Statutes authorizing Alterations.**—The English Companies Act of 1862 in its original form provided no mode for altering the memorandum of association except in respect to increasing the capital of the company and to changing its name.⁵ By an act of 1867, the power of reducing the capital was conferred subject to certain conditions.⁶ By a still later act,⁷ a power is conferred of altering the object clause of the memorandum whenever "it appears that the alteration is required in order to enable the company (1) to carry on its business more economically or efficiently, or (2) to attain its main purpose by new or improved means, or (3) to enlarge or change the local area of its operations, or (4) to carry on some business or businesses which under existing circumstances may conveniently or advantageously be combined with the business of the company, or (5) to restrict or abandon any of the objects specified" in the original instrument. In each case

paid-up shares without unanimous consent, a clause in an incorporation paper authorizing alterations in the instrument by majority vote is sufficient warrant for an alteration by mere majority vote changing in some respects the liability of holders of paid-up shares).

¹ Supra, § 120.

² Supra, § 120.

³ *Richards v. Minnesota Sav.*

Bank, 75 Minn. 196, 205 (headnote inadequate); 77 N. W. 822.

⁴ *Evans v. Chapman*, 86 L. T. 381.

⁵ Companies Act, 1862, § 12 and § 13.

⁶ Companies Act, 1867 (30 and 31 Vict., c. 131).

⁷ Companies (Memorandum of Association) Act, 1890 (53 and 54 Vict., c. 62).

the proposed alteration must receive the approval of the court; which is not to be given without affording to dissenting shareholders and to creditors an opportunity to be heard in opposition to the alteration.

In most of the United States, the statutes provide a method of making some alterations in, or amendments to, incorporation papers; and not infrequently a power is conferred, unlimited in terms, of making any alterations that may be desired.

§ 147-§ 149. *What Alterations are authorized by enabling Statutes.*

§ 147. *In general.* — Even where statutes confer a power of alteration broadly, without any express limitation whatsoever, nevertheless, it is submitted that no complete and radical change, creating, in substance, a new corporation, could be made against the opposition of any shareholder.¹ For instance, a joint-stock insurance company cannot amend its incorporation paper so as to give the policy-holders the right to vote at meetings of the company, and thus virtually convert the company from a joint-stock company into a mutual company.² *A fortiori*, where the statute expressly provides that no amendment shall “change substantially the purposes” of the company, a corporation formed for the purpose of manufacturing gas and electricity

¹ But see *Mercantile Statement Co. v. Kneal*, 51 Minn. 263; 53 N. W. 632; *David Bradley Mfg. Co. v. Chicago, etc. Traction Co.* (Ill.), 82 N. E. 210 (amendment changing object of company from construction of a street railway or tramway to construction of an interurban commercial railway held valid).

As to what is a substantial change in the objects of the company, see *State v. Taylor*, 55 Ohio 61; 44 N. E. 513 (stated *infra*); *Commonwealth v. Licking Valley Bldg. Ass'n*, 82 S. W. 435; 26 Ky. L. Rep. 730 (where a so-called amendment was held to have created a new corporation); *Picard v. Hughey*, 58 Ohio St. 577; 51 N. E. 133 (where, under a statute expressly prohibiting any amendment which should change

substantially the purposes of the organization, a gas company was allowed to amend its incorporation paper so as to acquire power to furnish electric light).

As to whether the alteration may authorize an abandonment of the original chief object of the company, compare *Thellusson v. Valentia* (1907), 2 Ch. 1 (where the “rules” of an unincorporated club, which originally provided for pigeon-shooting and which by amendment had been enlarged so as to include other sports, were permitted to be further amended so as to provide for discontinuing pigeon-shooting at the club).

² *Lord v. Equitable Life Ass. Soc.*, 96 N. Y. Supp. 10; 109 N. Y. App. Div. 252.

for light, heat, or power cannot amend its incorporation paper so as to add to its objects the operation of a street railway.¹ Even where the power of amendment is in terms unlimited, the company may not make an alteration reducing the rate of the preferential dividend on the preferred shares as fixed in the original instrument,² or avoiding valid contracts of the corporation.³

On the other hand, the statutory power of amendment, unless in terms restricted, applies to all the clauses of the original instrument,⁴ such, for example, as the clause fixing a limit to the period of corporate existence,⁵ or determining the corporate name,⁶ or the clause marking out the objects of the company,⁷ except possibly the clause fixing the amount of the capital.⁸ Statutory power to alter the nature of the business carried on by the company authorizes a change in the place, as specified in the incorporation paper, at which the business is to be carried on, even though the character of the business is not altered.⁹ Where a railway company has power to alter its incorporation paper for the purpose of correcting an informality or defect in the original instrument, an amendment which makes a change in the proposed route is not permissible.¹⁰

¹ *State v. Taylor*, 55 Ohio St. 61; 44 N. E. 513.

² *Pronick v. Spirits Distributing Co.*, 58 N. J. Eq. 97; 42 Atl. 586. Cf. *infra*, § 672-§ 674.

³ Cf. *Brown v. Grand Fountain*, 28 App. D. C. 200. See also *infra*, § 722-§ 724.

⁴ Cf. *Bernstein v. Kaplan* (Ala.), 43 So. 581 (headnote inadequate — construing a statute which after empowering the corporation to alter the instrument in certain particulars concluded by authorizing “such other alteration, amendment, or change of its charter as may be desired”); *Fidelity Mut. Aid Ass’n*, 12 Wkly. Notes Cas. (Pa.) 269, 271 (“A general power to alter or amend a charter is a power to alter or amend any part of the charter”).

⁵ *People ex rel. Ward v. Green*, 116 Mich. 505; 74 N. W. 714; *Ovid Elevator Co. v. Secretary of State*, 90 Mich. 466; 51 N. W. 536.

As to alterations in the voting rights of the shareholders, see *Loewenthal v. Rubber Reclaiming Co.*, 52 N. J. Eq. 440; 28 Atl. 454 (where the statute authorizing amendments was passed after the execution of the original incorporation paper).

⁶ *Fort Pitt B. & L. Ass’n v. Model Plan B. & L. Ass’n*, 159 Pa. 308; 28 Atl. 215.

⁷ *Mercantile Statement Co. v. Kneal*, 51 Minn. 263; 53 N. W. 632.

⁸ *Continental Varnish, etc. Co. v. Secretary of State*, 87 N. W. 901; 128 Mich. 621. As to increase or reduction of capital, see further *infra*, Chapter XI.

⁹ *Meredith v. New Jersey Zinc, etc. Co.*, 59 N. J. Eq. 257 (headnote inadequate); 44 Atl. 55.

¹⁰ *Riverhead, etc. R. R. Co.*, 36 N. Y. App. Div. 514; 55 N. Y. Supp. 938.

less is carried on, the court in con-
memorandum of association enlarg-
ments exacted as a condition that the
and so as no longer to suggest that the
confined to the place mentioned in the
a somewhat similar case a Scotch court
change of name was necessary.²

payable on Amendment. — The fees payable on
amended instrument are usually if not always
statute. Where one section of a statute prescribes
filing any amended incorporation paper and another
provides that on an extension or renewal of corporate
the same fees shall be payable as are required for an
original incorporation, a corporation wishing to prolong its
corporate existence so that instead of being fifty years as fixed
in the certificate of incorporation the corporate existence shall
be perpetual, cannot by filing an amended certificate with an
alteration in the clause relating to the period of corporate
existence escape with payment of merely such fees as are required
for filing of an amendment to the incorporation paper, but must
pay the much heavier fees required for filing a certificate of
extension of corporate existence.³

§ 152. **Effect of Amendment on Instrument originally void
or on previous invalid Amendment.** — While an instrument
originally void cannot be made valid by an amendment duly
executed and filed,⁴ yet in such a case what was intended as an
amended instrument may, if it contain all the statutory requi-
sites, operate as an original incorporation paper.⁵ An amend-
ment attempted to be made at a time when no power of

Trust Co. (1891), 2 Ch. 395; *Govern-
ments Stock Investment Co.* (No. 2),
(1892), 1 Ch. 597; *Alliance Marine
Ass. Co.* (1892), 1 Ch. 300; *National
Boiler Ins. Co.* (1892), 1 Ch. 306.

¹ *Indian Mechanical Gold Ex-
tracting Co.* (1891), 3 Ch. 538.

² *Kirkcaldy Steam Laundry Co.*, 6
Fraser (Sc.) 778.

³ *National Lead Co. v. Dickinson*,
57 Atl. 138; 70 N. J. Law 596; af-
firmed short, 62 Atl. 1135.

⁴ *State ex rel. Clapp v. Critchett*,
37 Minn. 13; 32 N. W. 787.

⁵ *People ex rel. New York, etc.
R. R. Co. v. Railroad Comm'rs*, 81
N. Y. App. Div. 242; 81 N. Y. Supp.
20, affirmed short, 67 N. E. 1088.

This was recognized in *State ex
rel. Clapp v. Critchett*, 37 Minn. 13,
14; 32 N. W. 787.

Cf. *Valk v. Crandall*, 1 Sandf. Ch.
(N. Y.), 179; *State ex rel. Thompson
v. Colias* (Ala.) 43 So. 190 (where a
statute expressly authorized the cur-
ing of defects in the original paper
by filing a supplement thereto).

amendment existed may be recognized and validated by a subsequent amendment adopted after a passage of a statute authorizing amendments to be made.¹

§ 153. **Alteration against Opposition of Minority Shareholders.** — A power of altering the incorporation paper or any clause thereof, such as the clause fixing a limit to the period of corporate existence, if conferred by law when the original incorporation paper is executed, should be read into the contract between the several shareholders without any express reference thereto, so that the power may be exercised against the opposition of individual shareholders.² Indeed, it would seem that the statutory power of alteration would exist even in spite of an express clause in the original paper attempting to exclude its application.

§ 154. **Statute allowing Alteration unless prohibited in original Instrument.** — Where a statute authorizes an alteration of the incorporation paper, unless otherwise provided in that instrument itself, there must in order to preclude alteration be an express prohibitory clause in the instrument.³

§ 155. **Formalities required in making Alteration.** — Unless otherwise provided by statute, an amendment to an incorporation paper must be acknowledged and recorded in the same way as the original instrument.⁴ Where an amendment is required

¹ *People ex rel. Ward v. Green*, 116 Mich. 505; 74 N. W. 714.

Cf. *Spinning v. Home Building, etc. Ass'n*, 26 Ohio St. 483.

² *Smith v. Eastwood Wire Mfg. Co.*, 58 N. J. Eq. 331; 43 Atl. 567; *Port Edwards, etc. Ry. Co. v. Arpin*, 80 Wisc. 214; 49 N. W. 828 (holding dissenting shareholders not released from obligation to pay calls by amendment increasing capital in pursuance of statute in force at time of incorporation).

But cf. *Pronick v. Spirits Dist. Co.*, 42 Atl. 586; 58 N. J. Eq. 97.

³ *Meredith v. New Jersey Zinc, etc. Co.*, 59 N. J. Eq. 257 (headnote inadequate); 44 Atl. 55.

⁴ *Day v. Mill Owners' Mut. Fire Ins. Co.*, 75 Iowa 694; 38 N. W. 113; *Anderson v. Railroad*, 91 Tenn. 44,

52-53; 17 S. W. 803 (holding that amendment is not effective until recorded not only in county record office but also with the secretary of state).

Cf. *Lamb & Sons v. Dobson*, 90 N. W. 607; 117 Iowa 124.

But see *Boca, etc. R. R. Co. v. Sierra Valleys Ry. Co.* (Cal.), 84 Pac. 298, 301; *Jackson v. Crown Point Mining Co.*, 21 Utah 1; 59 Pac. 238; 81 Am. St. Rep. 651 (where it was held that although an amendment which is "fundamental" is not effective until recorded as required by statute, yet an amendment which is not "fundamental" — such as an amendment increasing the number of directors — is valid although not recorded).

to be recorded, it does not take effect until recorded; and when recorded it does not relate back to the time of passage of the amendatory resolution.¹ A statute which requires as a condition to the making of an alteration of the instrument that the "board of directors shall pass a resolution declaring that such change * * * is desirable and calling a meeting" of the shareholders to take action accordingly, is satisfied by the passage by the directors of a resolution calling a meeting of the shareholders to make the amendment, but without in terms stating that such amendment is approved, especially where the meeting of shareholders is attended by all the directors (a majority of whom vote in favor of the resolution) and by all the shareholders.² Where a statute provides one method for making a change in a particular clause or paragraph of the incorporation paper, a subsequent statute providing a different method for making alterations in any part of the incorporation paper, repeals the former statute, so that the method therein provided can no longer be pursued.³

§ 156. **Whether Alteration should be made by Directors or Shareholders.** — Where the power of amending the incorporation paper is conferred upon the corporation, and not expressly upon the directors, it can only be exercised by the shareholders;⁴ for as will be shown below, the powers of directors are confined to the ordinary business of the company and cannot be extended to any alteration of the company's constitution.⁵

§ 157. **Irregular Alteration — Acquiescence in Alteration by unauthorized Officers.** — If an amendment to the incorporation paper is adopted by the officers and duly recorded, the shareholders, after being thus charged with constructive notice thereof and after acquiescing for a number of years, will not subsequently be heard to assert a lack of authority in the officers

¹ *Westchester Trust Co.*, 186 N. Y. 215.

But see *Humphrey v. Patrons' Mercantile Ass'n*, 50 Iowa 607 (holding that a contract permitted by the amended but not by the original incorporation paper, and entered into after the execution but before the recording of the amended instrument, cannot be attacked as *ultra vires* by the corporation itself).

² *Bernstein v. Kaplan* (Ala.), 43 So. 581.

³ *Fort Pitt B. & L. Ass'n v. Model Plan B. & L. Ass'n*, 159 Pa. St. 308; 28 Atl. 215.

⁴ *Cressona Sav. Fund, etc. Ass'n*, 1 Leg. Rec. (Pa.) 245.

⁵ *Infra*, § 1438.

who adopted the amendment, for the purpose of escaping the payment of a tax to which the amendment subjected the company.¹

Other Irregularities. — Indeed, the existence of irregularities in the proceedings whereby the amendment is made will not always be fatal to the validity of the amendment, according to some American authorities.² Perhaps, the question depends to some extent on the nature of the irregularities. Minor irregularities may perhaps be cured by acquiescence. But a total lack of compliance might render the amendment void, as against any person not concluded by estoppel.³

A failure properly to acknowledge an amendment to the incorporation paper, or other irregularity in the proceedings for making the alteration, does not work a dissolution of the company, but is at worst a cause of forfeiture of corporate privileges to be taken advantage of only by the state.⁴ Indeed, it would seem that such an irregularity should not even be a cause of forfeiture,⁵ but that the right of the company to continue under the original incorporation paper should not be affected by the abortive attempt at amendment.

§ 158. **Amendments not retroactive.** — An amendment has no retroactive effect.⁶ It does not validate any previous transactions which were *ultra vires* under the original instrument but which would be proper under the amended paper. For example, where a corporation institutes condemnation proceedings to acquire land for a line of railway which under its incorporation paper it has no power to construct, an amendment to the incorporation paper adopted pending the proceed-

¹ *Licking Valley Bldg. Ass'n v. Commonwealth* (Ky.), 89 S. W. 682.

² *Pope v. Merchants' Trust Co.* (Tenn.), 103 S. W. 792; *International Savings, etc. Co. v. Stenger*, 31 Pa. Super. Ct. 294 (as to a change of corporate name). And see *infra*, § 592 and § 645.

³ See *Fort Pitt B. & L. Ass'n v. Model Plan B. & L. Ass'n*, 159 Pa. St. 308; 28 Atl. 215.

⁴ *Philadelphia, etc. Ferry Co. v. Intercity Link R. R. Co.* (N. J.), 62 Atl. 184.

Cf. *Brown v. Wyandotte, etc. Ry. Co.*, 68 Ark. 134, 144.

⁵ Cf. *Jackson v. Crown Point Mining Co.*, 21 Utah 1, 12; 59 Pac. 238; 81 Am. St. Rep. 651.

⁶ Cf. *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657, 662 (construing an express statutory provision "that the amended certificate shall take the place of the original certificate of incorporation and shall be deemed to have been recorded and filed on the date of recording and filing the original certificate").

ings so as to authorize the construction of the railway will not enable those proceedings to be maintained.¹

§ 159. **Creation of new Corporation by means of Amendment.** — What is in form a mere amendment of an incorporation paper may in some cases be construed as creating an entirely new corporation.² It has been said to be a question of intention whether a new corporation should be deemed to have been created or not.³ The mere fact that the amended paper is in form a new instrument is immaterial if in substance the differences between the two are not such as to make in effect a new corporation.⁴ An amendment merely changing the corporate name certainly does not create a new corporation.⁵

In New York, a statute forfeiting the franchises of any railway company which should not within five years commence its line and expend thereon ten per centum of the amount of its capital and within ten years after the filing of the "certificate of incorporation" complete the road and put it in operation, was held to apply to an extension of the original line authorized by an amendment to the certificate of incorporation, or incorporation paper, so that accordingly the periods of five and ten years began to run from the filing of the amendment.⁶ This case adopts a somewhat forced construction of the statute, but

¹ *Boca, etc. R. R. Co. v. Sierra Valleys Ry. Co.* (Cal.), 84 Pac. 298, 302-303.

Cf. *Westchester Trust Co.*, 186 N. Y. 215 (stated supra § 155); *Brown v. Grand Fountain*, 28 App. D. C. 200.

² *Commonwealth v. Licking Valley Bldg. Ass'n*, 82 S. W. 435; 26 Ky. L. Rep. 730 (amendment taxable as equivalent to creation of new corporation).

As to the effect of an amendment of the incorporation paper in making the company subject to burdensome laws from which it would otherwise have been exempt, see *Senn v. Levy* (Ky.), 63 S. W. 776; 23 Ky. Law Rep. 662, 1331; *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657, 662 (where the amendment made the company subject to a law authoriz-

ing consolidation with other corporations).

³ See *Allen v. North Des Moines M. E. Church*, 102 N. W. 808; 127 Iowa 96; 109 Am. St. Rep. 366; 69 L. R. A. 255; *Brown v. Maryland Telephone Co.*, 101 Md. 574, 581-582; 61 Atl. 338.

Cf. *Picard v. Hughey*, 58 Ohio St. 577, 594; 51 N. E. 133.

⁴ *Grand River College v. Robertson*, 67 Mo. App. 329; *Glymont Improvement, etc. Co. v. Toler*, 80 Md. 278, 290-291 (headnote inadequate); 30 Atl. 651.

⁵ *Wright Caesar Tobacco Co. v. A. Hoen & Co.* (Va.), 54 S. E. 309; *Picard v. Hughey*, 58 Ohio St. 577, 594; 51 N. E. 133 (semble). See also *infra*, § 446.

⁶ *Brooklyn, Queens County, etc. R. R. Co.*, 185 N. Y. 171, 183-184.

it does not proceed in any degree upon the ground that the amendment really creates a new corporation.

§ 160. **Legislative Alteration.** — The alteration considered in the last paragraphs, it will be borne in mind, is an alteration in pursuance of statutes existing when the company was incorporated. Of course, the only restraints upon the power of the legislature to amend an incorporation paper, or to authorize the company to amend it, by legislation passed subsequent to the organization of the company, must be found in constitutional limitations. The question of the validity of such subsequent legislation as applied to pre-existing corporations is, therefore, a constitutional one and accordingly outside our present subject. But in every case of such legislation not merely its validity but its construction must be passed upon; and it is submitted that no mere generalities should ever be held to sanction a complete and fundamental change in the company's constitution.¹

§ 161-§ 162. — *Constructive Notice of Contents of Instrument.*

§ 161. **In general.** — Undoubtedly, not only shareholders² but also all creditors and persons who deal with a corporation³ are charged with constructive notice of the company's incorporation paper. Of course, in point of fact, even the most prudent of them rarely has actual notice. Business would be paralyzed if every time a transaction were had with an incorporated company examination were made of its incorporation paper. But each person who deals with the company has the opportunity of knowledge. The instrument is a public document recorded in the office of a public official; and not only legal principle but public policy as well requires that the public should be affected with constructive knowledge of its

¹ Cf. *Brown v. Grand Fountain, Lumber Co.*, 52 Pac. 1067, 1070; 28 App. D. C. 200; *Miller v. Insurance Co.*, 92 Tenn. 167.

² *Sewell's Case*, 3 Ch. 131, 140 (headnote inadequate).

³ *Bent v. Underdown*, 156 Ind. 516 (headnote inadequate); 60 N. E. 307; *Bank of Monroe v. Gifford*, 72

Iowa, 750, 754 (headnote inadequate); 32 N. W. 669; *Canfield v. Gregory*, 66 Conn. 9; 33 Atl. 536; *Washington Mill Co. v. Sprague* 22-23; 9 Pac. 771; 59 Am. Rep. 134.

contents. If the law were otherwise, corporations would become little more than partnerships. After all, the hardship is more apparent than real. For if an unusual transaction or one of great magnitude is contemplated, every prudent man would examine the record; and in all cases of minor importance within the ordinary course of the company's business little risk is run by failing to do so.

§ 162. **Limits of Doctrine of Constructive Notice.** — The doctrine, however, of constructive notice, sound and salutary though it be, should not be carried too far or be perverted into an aid in the successful perpetration of fraud. Thus, a misrepresentation of the contents of the incorporation paper is none the less material and actionable because the person relying thereon has from the registry constructive notice of the document. For example, where a prospectus states with precision the objects of an intended corporation, and the incorporation paper, which is subsequently drawn up and recorded, confers much wider powers, a person who subscribed to shares on the faith of the prospectus cannot be charged with laches in failing to have his name removed from the list of shareholders until he acquires actual notice of the variance between the prospectus and the incorporation paper: mere constructive knowledge of the incorporation paper cannot constitute a foundation for an inference of acquiescence in the variation.¹ So, a sale of shares in a company which is represented by the vendor to be incorporated is voidable for misrepresentation if the company is not in truth incorporated, although the purchaser by investigation might have ascertained the facts.² Moreover, the doctrine of constructive notice cannot be extended to any provisions of the incorporation paper which it was unlawful to insert therein. For instance, a stipulation that subscribers to shares shall not be liable for more than fifty per cent of the par value of their shares is illegal, and therefore persons who may subsequently become creditors will not be affected with constructive notice of such a provision contained in the company's incorporation paper.³

¹ *Stewart's Case*, 1 Ch. 574, 587; *Webster's Case*, 2 Eq. 741. Cf. *infra*, § 216. ² *Security Trust Co. v. Ford* (Ohio), 79 N. E. 474 (headnote inadequate). Cf. *supra*, § 122.

³ *Bolton v. Prather* (Tex.), 80 S. W. 666; 35 Tex. Civ. App. 295.

for light, heat, or power cannot amend its incorporation paper so as to add to its objects the operation of a street railway.¹ Even where the power of amendment is in terms unlimited, the company may not make an alteration reducing the rate of the preferential dividend on the preferred shares as fixed in the original instrument,² or avoiding valid contracts of the corporation.³

On the other hand, the statutory power of amendment, unless in terms restricted, applies to all the clauses of the original instrument,⁴ such, for example, as the clause fixing a limit to the period of corporate existence,⁵ or determining the corporate name,⁶ or the clause marking out the objects of the company,⁷ except possibly the clause fixing the amount of the capital.⁸ Statutory power to alter the nature of the business carried on by the company authorizes a change in the place, as specified in the incorporation paper, at which the business is to be carried on, even though the character of the business is not altered.⁹ Where a railway company has power to alter its incorporation paper for the purpose of correcting an informality or defect in the original instrument, an amendment which makes a change in the proposed route is not permissible.¹⁰

¹ *State v. Taylor*, 55 Ohio St. 61; 44 N. E. 513.

² *Pronick v. Spirits Distributing Co.*, 58 N. J. Eq. 97; 42 Atl. 586. Cf. *infra*, § 672-§ 674.

³ Cf. *Brown v. Grand Fountain*, 28 App. D. C. 200. See also *infra*, § 722-§ 724.

⁴ Cf. *Bernstein v. Kaplan* (Ala.), 43 So. 581 (headnote inadequate — construing a statute which after empowering the corporation to alter the instrument in certain particulars concluded by authorizing “such other alteration, amendment, or change of its charter as may be desired”); *Fidelity Mut. Aid Ass’n*, 12 Wkly. Notes Cas. (Pa.) 269, 271 (“A general power to alter or amend a charter is a power to alter or amend any part of the charter”).

⁵ *People ex rel. Ward v. Green*, 116 Mich. 505; 74 N. W. 714; *Ovid Elevator Co. v. Secretary of State*, 90 Mich. 466; 51 N. W. 536.

As to alterations in the voting rights of the shareholders, see *Loewenthal v. Rubber Reclaiming Co.*, 52 N. J. Eq. 440; 28 Atl. 454 (where the statute authorizing amendments was passed after the execution of the original incorporation paper).

⁶ *Fort Pitt B. & L. Ass’n v. Model Plan B. & L. Ass’n*, 159 Pa. 308; 28 Atl. 215.

⁷ *Mercantile Statement Co. v. Kneal*, 51 Minn. 263; 53 N. W. 632.

⁸ *Continental Varnish, etc. Co. v. Secretary of State*, 87 N. W. 901; 128 Mich. 621. As to increase or reduction of capital, see further *infra*, Chapter XI.

⁹ *Meredith v. New Jersey Zinc, etc. Co.*, 59 N. J. Eq. 257 (headnote inadequate); 44 Atl. 55.

¹⁰ *Riverhead, etc. R. R. Co.*, 36 N. Y. App. Div. 514; 55 N. Y. Supp. 938.

§ 148. **Under British Act of 1890 and similar Statutes.** — The British courts have often been called upon to decide whether proposed changes in a company's objects can be brought within the power of alteration conferred by the Act of 1890, which has been already referred to.¹ In order to come within the clause authorizing an alteration in the objects which may enable the company to carry on its business more economically or efficiently, the proposed alteration must "leave the business of the company substantially what it was before, with only such changes in the mode of conducting it as will enable it to be carried on more efficiently."² Neither that clause nor the clause authorizing an alteration for the purpose of enabling the company to carry on some business that may be conveniently or advantageously combined with the old business will warrant a change whereby a club of cyclists is converted into a club to which tourists of any kind, particularly motorists, may be admitted.³ In one case, where it was sought to make an alteration which merely amplified the description of the company's objects by re-writing the object-clause and putting it in modern form, Cozens-Hardy, J., expressed disapproval, saying, "I do not think it is within the scope of the statute simply to improve the language of a memorandum of association — if it be an improvement — by re-writing the memorandum in modern form, and to enable a company to adopt one of Mr. Palmer's modern forms;"⁴ but it is understood that in a number of unreported cases precisely such changes were confirmed.⁵ It has been held in Newfoundland under an exactly similar statute that none of the clauses of the act — not even the clause authorizing an amendment "to restrict or abandon any of the objects" specified in the original instrument — will justify a clause to provide for a sale of the company's entire property, undertaking, and goodwill.⁶ In Australia, an amendment to the memorandum of association of a life insurance company vastly enlarging the classes of securities in which the

¹ Supra, § 146.Accord: *Australian Widows' Fund*² *Cyclists' Touring Club* (1907), *Life Ass. Soc.*, 24 Vict. L. R. 613.

1 Ch. 269, 274.

³ 1 Palmer's Company Precedents,⁴ *Cyclists' Touring Club* (1907), 9th ed., 1154-1155.

1 Ch. 269.

⁵ *St. John's Electric Light Co.*⁶ *Consett Iron Co.* (1901), 1 Ch. 236. (1897-1903), Newfoundland 440.

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§ 163. **When Corporate Existence begins.** — The execution and registration of the incorporation paper is the first step in the incorporation of a company under a general law; and usually upon the due registration of the incorporation paper, corporate existence at once commences.¹ To be sure, sometimes the payment of some tax or fee is made an additional condition precedent to incorporation,² and sometimes other conditions precedent, such as the issuance by some public official of a certificate of due incorporation, are prescribed.³ But while in the case of incorporation by special act some acceptance of the act by the incorporators is a condition precedent to the commencement of the corporate life, nothing of the sort is requisite in case of incorporation under a general law. No acceptance is necessary beyond the execution of the incorporation paper.⁴ Nor is the organization of the corporation by election of officers or otherwise a prerequisite to its existence.⁵ Of course, the perfection of the organization is practically essential in order to

¹ *Hunt v. Kansas, etc. Bridge Co.*, 11 Kans. 412; *Badger Paper Co. v. Rose*, 95 Wisc. 145; 70 N. W. 302; 37 L. R. A. 162; *Chicago, etc. R. R. Co. v. Stafford Co.*, 36 Kans. 121; 12 Pac. 593; *Atherton v. Sugar Creek, etc. Co.*, 67 Ind. 334; *Fayetteville, etc. Ry. v. Aberdeen, etc. R. R. Co.* (N. Car.), 55 S. E. 345; *Stokes v. Findlay*, 4 McCrary 205; *Rose Hill & Road Co. v. People ex rel. Lawless*, 115 Ill. 133; 3 N. E. 725.

Cf. *Braddock v. Penn Water Co.*, 189 Pa. St. 379; 42 Atl. 15; *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385.

² *Maryland Tube Works v. West End Imp. Co.*, 87 Md. 207; 39 Atl. 620; 39 L. R. A. 810; *Cleveland v. Mullin*, 96 Md. 598; 54 Atl. 665; *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143.

In such cases, upon payment of the tax, does the corporate existence relate back to time of recording of the instrument? Cf. *Gill's Adm'x v. Ky., etc. Mining Co.*, 7 Bush (Ky.) 635, 639 (headnote inadequate), and the Maryland cases cited above.

³ See *supra*, § 142.

⁴ *Glymont, etc. Co. v. Toler*, 80 Md. 278; 30 Atl. 651; *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454.

Cf. *Dorsey Harvester Revolving-Rake Co. v. Marsh*, 7 Fed. Cas. 939, 941-942; *Brooke v. Day* (Ga.), 59 S. E. 769.

⁵ *Judah v. American, etc. Ins. Co.*, 4 Ind. 333; *Ashtabula, etc. R. R. Co. v. Smith*, 15 Ohio St. 328; *Middleton v. Arastraville Mining Co.*, 146 Cal. 219, 222; 79 Pac. 889; *Atherton v. Sugar Creek, etc. Co.*, 67 Ind. 334; *Drake v. Herndon* (Ky.), 91 S. W. 674.

launch the company on its career; but technically it springs at once into existence without anything of the sort.¹ So, while the subscription of the company's capital is sometimes made by express statute a condition precedent to incorporation,² yet in the absence of any such provision the corporation may come into existence before its capital is subscribed.³ *A fortiori*, payment of the subscriptions to the capital is not a condition precedent to corporate existence.

§ 164-§ 167. *Status of Signers of Incorporation Paper from Moment of Incorporation.*

164. **Under Laws which require Signers to take one or more Shares.** — We have seen above that some incorporation laws provide that each subscriber of the incorporation paper must

But see *Aspen Water, etc. Co. v. Aspen*, 5 Colo. App. 12; 37 Pac. 728; *Wechselberg v. Flour City Nat. Bank*, 64 Fed. 90; 12 C. C. A. 56; 26 L. R. A. 470; *Laurie v. Silsby*, 56 Atl. 1106; 76 Vt. 240; 104 Am. St. Rep. 927 (depending on a statutory provision that the company "when organized" should have power to sue as a corporation); *Cazalais v. Picotte*, 18 Quebec Sup. Ct. 538; *McVicker v. Cone*, 21 Oreg. 353; 28 Pac. 76; *Walton v. Oliver*, 49 Kans. 107; 33 Am. St. Rep. 355; 30 Pac. 172; *Brooke v. Day* (Ga.), 59 S. E. 769.

- Said the court in *Duke v. Cahawba Nav. Co.*, 10 Ala. 82, 90; 44 Am. Dec. 472: "By the organization of a company, we understand the meeting of individuals claiming to be corporators, and their action in choosing officers and agents."

Note, that if any irregularity exist in the incorporation paper or in the recording of the same, an organization of the company must be proved in order to establish a *de facto* corporate existence: *Martin v. Deetz*, 102 Cal. 55; 36 Pac. 368; 41 Am. St. Rep. 151. See *infra*, § 290.

¹ "When the memorandum is

duly signed and registered, though there be only seven shares taken, the subscribers are a body corporate 'capable forthwith' to use the words of the enactment, 'of exercising all the functions of an incorporated company.' These are strong words. The company attains maturity on its birth. There is no period of minority — no interval of incapacity." *Salomon v. Salomon & Co.* (1897), A. C. 22, 51, per Lord Macnaghten. But now see Companies Act of 1900, § 6.

² *Jersey City Gas Co. v. Dwight*, 29 N. J. Eq. 242 (where the statute required the subscription of half and the payment of twenty per cent of the capital before the registration of the incorporation paper); *McVicker v. Cone*, 21 Oreg. 353, 357 (headnote inadequate); 28 Pac. 76.

Cf. *Belfast, etc. Plank Road Co. v. Chamberlain*, 32 N. Y. 651, 654-655 (stated *supra*, § 112).

³ *Nat. Bank of Jefferson v. Texas Investment Co.*, 74 Tex. 421, 435-436; 12 S. W. 101; *Minor v. Mechanics Bank of Alexandria*, 1 Pet. 46, 62-65; *Hunt v. Kansas, etc. Bridge Co.*, 11 Kans. 412; *Willamette Freighting Co. v. Stannus*, 4

by his subscription agree to take at least one share in the company, the precise number which he promises to take being indicated by him at the time.¹ Under such laws — and the majority of recent incorporation laws are of that class — there may be a nice question whether the signatories of the incorporation paper become at once actual shareholders as distinguished from persons who have agreed to become shareholders. Of course, they are members of the company from the very moment of its incorporation; and no further act, such as entering their names on a register of members can be necessary in order to constitute them members of the corporation.² But although they are members, are they shareholders? Are they not rather persons who have agreed and become bound to become shareholders and who constitute the corporation, temporarily, for the purpose of setting it in regular motion by the allotment and issue of shares? On principle, such might well be their position. Nevertheless, we should note that the shares which a signer of an incorporation paper agrees by his subscription to take have been deemed in England to be “issued” within the meaning of Section 25 of the Companies Act of 1867 as soon as the instrument is recorded;³ and if this proposition be logically carried out it would seem to follow that the signers of the incorporation paper are shareholders from the very commencement of corporate existence.⁴ Moreover, in a case in the District of Columbia it was held that the signers of an incorporation paper are shareholders from the moment of incorporation and as such are qualified, and the only persons qualified, to

Oreg. 261; *Johnson v. Kessler*, 76 Iowa 411; 41 N. W. 57; *Thornton v. Balcom*, 85 Iowa 198; 52 N. W. 190; *Jersey City Gas Co. v. Dwight*, 29 N. J. Eq. 242; *Chicago, etc. R. R. Co. v. Stafford Co.*, 36 Kans. 121; 12 Pac. 593.

But see *Aspen Water Co. v. Aspen*, 5 Colo. App. 12; 37 Pac. 728; *Continental, etc. Paint Co. v. Secretary of State*, 128 Mich. 621; 87 N. W. 901.

¹ Supra, § 132.

² *Florence Land, etc. Co.*, 29 Ch. D. 421, 445. Said Fry, L. J.: “It does not appear to me that

entry on the register is a condition precedent, in the case of subscribers of the memorandum, to their becoming members. In fact, I cannot see how it can possibly be so; because until the company is formed no register can be made, and until there are some members the company cannot be formed.”

³ *Jarvis's Case* (1899), 1 Ch. 193 (semble); *Ebenezer Timmins & Sons* (1902), 1 Ch. 238; *Dalton Time Lock Co. v. Dalton*, 66 L. T. 704.

⁴ See also *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385.

be directors.¹ In an early Indiana case, where the incorporation act provided that the subscribers to stock should subscribe the incorporation paper and that the first directors should be elected by the stockholders, it was held that the subscribers of the incorporation paper might elect the directors even before the recording of the instrument.²

§ 165. **Under Laws which do not require Signers of Incorporation Paper to agree to take Shares.** — As stated above, some incorporation laws do not require the signers of the incorporation paper to agree to take shares in the company;³ and under these statutes, of course, the subscribers of that instrument are not shareholders but are mere promoters whose function it is to organize the company and set it in motion.⁴ Their position is similar to that of "commissioners to take stock," who were often appointed in special acts of incorporation for the purpose of organizing the company by allotting and issuing shares and of turning the company over to the shareholders, its permanent proprietors. The duty of such commissioners was to offer the shares of stock for public subscription, and their connection with the enterprise terminated as soon as the corporation could be turned over to its permanent constituents and proprietors, namely, the shareholders. Even, however, where the general incorporation law does not require the signers of the incorporation paper to agree to take shares in the company, nevertheless it would seem that until shares are allotted and issued, the signers of the incorporation paper necessarily constitute the company, and are for the time being the supreme authority in corporate affairs.⁵

Their powers, however, come to an end as soon as a regular

¹ *Dancy v. Clark*, 24 App. D. C. 487, 506-509. *Bank*, 64 Fed. 90; 12 C. C. A. 56; 26 L. R. A. 470; *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385.

² *Covington, etc. Plank Road Co. v. Moore*, 3 Ind. 510. But see *Coyote, etc. Co. v. Ruble*, 8 Oreg. 284, 292-293; *Trammell v. Pennington*, 45 Ala. 673 (holding that a county has no authority to subscribe for stock on the application of the signers of the incorporation paper and before the organization, issue of shares and election of officers); 1 Morawetz on Priv. Corps., 2d ed., § 33.

³ *Supra*, § 132.

⁴ *Coyote, etc. Co. v. Ruble*, 8 Oreg. 284; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43, 54.

⁵ *Hunt v. Kansas, etc. Bridge Co.*, 11 Kans. 412, 440; *Chase v. Lord*, 77 N. Y. 1, 11; *Singer Mfg. Co. v. Peck*, 9 S. Dak. 29; 67 N. W. 947. Cf. *Wechselberg v. Flour City Nat.*

organization is effected by issue of shares and appointment of directors.¹

As was said by Danforth, J., in a New York case, "The corporators are the associates who are the getters-up of the company, and whose functions cease with its organization * * * * Corporators exist before stockholders, and do not exist with them. When stockholders come in, corporators cease to be."² Under this system, as soon as the necessary number of shares are subscribed, and the shareholders brought together and organized, the signers of the incorporation paper simply drop out, and the shareholders thenceforward constitute and control the corporation. Moreover, it has been held that if the corporators carry on business without issuing stock as contemplated in the incorporation paper, they are liable as partners for all debts so contracted.³ This decision proceeds upon the theory that until shares of stock are regularly issued the corporation "can only be said to have existence in a very limited and qualified sense," and that until then limited liability is not attained. The decision rested largely on the special terms of a Wisconsin statute; and moreover its authority is considerably weakened by a very vigorous and able dissenting opinion. Accordingly, the South Dakota court refused to apply the principle of the last cited decision to a similar case arising under the South Dakota statutes.⁴ Of course if the corporators carry on business before recording the certificate or performing other conditions precedent to incorporation, they may be subject to a partnership liability (unless the company can be deemed a *de facto* corporation) as members of an unincorporated association.⁵

§ 166. **Mode of Action by Corporators.** — Action taken by subscribers of the incorporation paper, being corporate action, should be taken at a meeting convened upon reasonable notice

¹ *Ellison v. Mobile, etc. R. R. Co.*, 36 Miss. 572; *Wechselberg v. Flour City Nat. Bank*, 64 Fed. 90, 97; 12 C. C. A. 56; 26 L. R. A. 470 (semble); *Chase v. Lord*, 77 N. Y. 1, 11.

Cf. *Wellersburg, etc. Plank Road Co. v. Hoffman*, 9 Md. 559, 568-569 (as to the functions of commissioners to take stock).

² *Chase v. Lord*, 77 N. Y. 1, 11.

³ *Wechselberg v. Flour City Nat. Bank*, 64 Fed. 90; 12 C. C. A. 56; 26 L. R. A. 470.

⁴ *Singer Mfg. Co. v. Peck*, 9 S. Dak. 29; 67 N. W. 947.

⁵ *Ryland v. Hollinger*, 117 Fed. 216 (semble, as to Missouri law). See also *infra*, § 293.

to all of them.¹ Indeed, such meetings would seem to be governed in the main by the same rules of law as shareholders' meetings.²

§ 167. **Clerks and other Subordinates as Corporators.** — Often, indeed commonly, the incorporators or signers of the incorporation paper are not the substantial promoters of the enterprise, but mere clerks or dummies. This practice has been judicially disapproved, and is undoubtedly foreign to the intent of the incorporation laws.³

§ 168. **The First Directors.** — Directors for the first year of the company's existence are oftentimes named in the incorporation paper or appointed under its provisions;⁴ and some incorporation laws provide that the subscribers of the incorporation paper shall act as directors during the first year of the company's existence. Any such first directors have the same powers as directors chosen by the shareholders;⁵ and to them therefore are usually entrusted the practical details of organization and allotment and issue of shares. Nevertheless, it would seem that the signers of the incorporation paper, constituting as they do

¹ Cf. *Low v. Conn., etc. R. R. Co.*, 45 N. H. 370, 379-380 (as to action by persons named as corporators in a special act of incorporation); *Woolf v. East Nigel Gold Mining Co.*, 21 Times L. R. 660 (notice of meeting of corporators sent out before incorporation, held not valid).

² For a summary of the English cases as to action by subscribers of the incorporation paper, see *infra*, § 1466.

³ "It is insisted that these corporators are merely nominal parties, and should not be regarded as contractors in any sense; that it has become common practice to take, for the time being, any persons who may be convenient for the purpose, leaving the real projectors to come in with the subscription for stock. Such view or practice is entirely

foreign to the manifest intent of the statute, as the organization is placed entirely within the control of the signers, and without their action to that end strangers cannot obtain admission as stockholders." *Wechselberg v. Flour City Nat. Bank*, 64 Fed. 90, 97; 12 C. C. A. 56; 26 L. R. A. 470.

⁴ See *supra*, § 115. As to the election of the first directors by the subscribers of the incorporation paper before the instrument is recorded, see *Covington, etc. Plank Road Co. v. Moore*, 3 Ind. 510; *Möller v. Maclean*, 1 Megone, 274.

⁵ *Middleton v. Arastraville Mining Co.*, 146 Cal. 219, 222; 79 Pac. 889; *Hamilton Trust Co. v. Clemes*, 163 N. Y. 423; 57 N. E. 614.

But see *Allman v. Havana, etc. R. R. Co.*, 88 Ill. 521, 524.

for the time being the members of the corporation, would necessarily have the power, if they should choose to exercise it, of stepping in and controlling the actions of these directors, to the same extent as shareholders of a fully organized corporation may step in and control the actions of the directors.¹ Of course, the first directors that are chosen by the shareholders after shares have been issued do not differ in any respect from directors chosen after the company has been actively engaged in business.

§ 169-§ 176. ALLOTMENT AND ISSUE OF SHARES.

§ 169. **Issue of Shares necessary to complete Organization.** — Even where the subscribers of the incorporation paper are shareholders in the company, and *a fortiori* where they are not, although the technical incorporation may be complete on the registration of the paper, yet the company is not regularly organized until shares are allotted and issued, and the permanent organization effected. This process of organization, therefore, next demands attention.

§ 170-§ 174. *Who are Shareholders — What constitutes an Issue of Shares.*

§ 170. **Statement of Question.** — In the first place, the question must be considered what is necessary to constitute a shareholder as distinguished from a person who has merely agreed to become a shareholder.² When may shares be said to be issued?

§ 171. **Issue of Share-Certificate not necessary.** — At the outset, it is clear that the issue of a share-certificate is not necessary in order to make a person a shareholder. A certificate is merely convenient evidence of his title, and a person may undoubtedly be a shareholder in a corporation although no certifi-

¹ As to these powers see *infra*, § 1191, § 1440, § 1441. a shareholder at a future time; and a contract to become a shareholder

² "It is important to distinguish between the contract of membership actually existing among the shareholders or members of a corporation, and a contract to become a shareholder at a future time must again be distinguished from a contract to purchase shares which have already been issued." 1 Morawetz on Priv. Corps., 2d ed., § 46.

cate has ever been issued to him ¹ or although his certificate may have been lost or stolen, or although the certificate delivered to him leaves a blank for his name.² Hence, in an action by a corporation on a contract of subscription to its shares, while the company must show that it was ready and able to carry out its part of the contract by issuing the shares as agreed,³ yet there is no necessity for proving a tender of a share-certificate.⁴ For the same reason, where land is conveyed to a corporation in consideration of an issue of its shares to the grantor, the company may be deemed a purchaser for value, so as to cut off undisclosed equities, even before any share-certificate is issued.⁵ Hence, too, the fact that no certificate is to be issued within a year after the subscription does not bring the agreement within the clause of the statute of frauds as to contracts not to be performed within a year.⁶ So also, in pleading, as for example in an action for unpaid dividends by a holder of preferred shares, the share certificates are not of the substance of the issue;⁷ and if the pleader chooses to set them out in the pleadings according to their tenor, they should not be excluded as evidence because

¹ *Blyth's Case*, 4 Ch. D. 140; *Clark's Case*, 8 Ch. D. 635 (semble); *Hawley v. Upton*, 102 U. S. 314 (where the court used "subscriber" in the sense of shareholder); *Smith v. Gower*, 63 Ky. 17; *San Joaquin, etc. Co. v. Beecher*, 101 Cal. 70; 35 Pac. 349; *Barron v. Burrill*, 86 Me. 66; 29 Atl. 939; *California, etc. Hotel Co. v. Callender*, 94 Cal. 120; 29 Pac. 859; 28 Am. St. Rep. 99; *Mass. Iron Co. v. Hooper*, 7 Cush. (Mass.) 183, 188 (headnote inadequate); *Agricultural Bank v. Burr*, 24 Me. 256; *Burr v. Wilcox*, 22 N. Y. 551; *Cotter v. Butte, etc. Smelting Co.*, 77 Pac. 509 (headnote inadequate); 31 Mont. 139; *South Dakota v. North Carolina*, 192 U. S. 286; 24 Sup. Ct. 269; *Corwith v. Culver*, 69 Ill. 502; *Pacific Nat. Bank v. Eaton*, 141 U. S. 227, 230; 11 Sup. Ct. 984.

But see *Bush's Case*, 9 Ch. 554; *Pietsch v. Krause*, 93 N. W. 9; 116 Wisc. 344 (the words "issue any

stock" and "stock issued" held to refer to the issue of certificates).

² *Sanger v. Upton*, 91 U. S. 56, 63-64.

³ *Carter, etc. Co. v. Hazzard*, 65 Minn. 432; 68 N. W. 74; *Oler v. Baltimore, etc. R. R. Co.*, 41 Md. 583.

⁴ *Webb v. Baltimore, etc. R. R. Co.*, 77 Md. 92; 26 Atl. 113; 39 Am. St. Rep. 396; *Smith v. Gower*, 63 Ky. 17; *Slipher v. Earhart*, 83 Ind. 173; *Fulgum v. Macon, etc. R. R. Co.*, 44 Ga. 597 (*Quære*, whether the reasoning in this case can be supported); *Marson v. Deither*, 49 Minn. 423; 52 N. W. 38; 2 Clark & Marshall on Priv. Corps., § 462 d.

Cf. *Hawley v. Upton*, 102 U. S. 314.

⁵ *Frenkel v. Hudson*, 82 Ala. 158; 2 So. 758; 60 Am. St. Rep. 736. Cf. *infra*, § 175.

⁶ *Reed & McCormick v. Gold* (Va.), 45 S. E. 868.

⁷ But see *infra*, § 1360.

of verbal inaccuracies in the description.¹ As a certificate is of merely evidential value, it follows that certificates issued before the incorporation may, if recognized by the company, have the same effect as if issued after incorporation.²

§ 172. **Entry of Shareholder's Name on Register necessary in England.** — In England, by virtue of certain provisions in the Companies Act, entry on the company's register of shareholders is, with the possible exception of subscribers of the memorandum of association,³ a condition precedent to becoming a shareholder.⁴ A person may have a right to become a shareholder, but unless and until his name is entered on the company's register of shareholders he cannot be an actual shareholder. The stubs of a certificate book cannot constitute a register of shareholders within the meaning of this rule.⁵ On the other hand, a person may be a shareholder although the register on which his name is entered does not in all respects comply with the statutory requirements.⁶ But while entry of one's name on the register is necessary, it is not, taken by itself, sufficient, to render a person a shareholder. In addition, it must be shown that the entry was with his knowledge and assent or acquiescence.⁷

§ 173. **American Rules as to Entry on Register.** — This rule that only those persons whose names have been entered on the register can be deemed actual shareholders, as distinguished from persons who have agreed to become shareholders, is very convenient in practice. For it is very desirable to have some simple criterion for determining whether a person is a shareholder or not. Nevertheless, many, perhaps most, American courts would hold that no such rule can be enforced unless affirmatively laid down by statute.⁸ According to this view of

¹ *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491.

² *Thorpe v. Pennock Mercantile Co.* (Minn.), 108 N. W. 940.

³ See *Florence Land Co.*, 29 Ch. D. 421; *Ebenezer Timmins & Sons* (1902), 1 Ch. 238; and *supra*, § 164.

⁴ *Florence Land Co.*, 29 Ch. D. 421; *MacDonald, Sons & Co.* (1894), 1 Ch. 89.

⁵ *MacDonald, Sons & Co.* (1894),

1 Ch. 89 (note the argument for the liquidator). Cf. *infra*, § 864.

⁶ *East Gloucestershire Ry. Co. v. Bartholomew*, L. R. 3 Ex. 15.

⁷ *Arnot's Case*, 36 Ch. D. 702; *Plimsoll's Case*, 24 L. T. 653; *Welch v. Gillelen*, 82 Pac. 248; 147 Cal. 571 (construing a statute similar to the British law). See also § 873.

⁸ Cf. *Troy, etc. R. R. Co. v.*

Tibbits, 18 Barb. (N. Y.) 297;

the common law, all that is necessary to constitute a person a shareholder is a present intention on his part and on the part of the company that the relation of shareholder and corporation subsist between them. When once that intention exists, the relationship is *eodem instanti* established without the necessity of any formality whatsoever.¹ The same rule has been applied even where it is expressly provided that the shares shall be transferable only by entry in the company's books; for that provision, it was held, does not refer to an original issue of shares but only to transfers from one shareholder to another.² Nevertheless, it is submitted that a different decision would have been more in accord with the spirit of the provision in question. A subscriber, however, who is in default in payment of a deposit payable on allotment is not entitled to the rights of a shareholder,³ even though he may be subject to the burdens. And sometimes acts of incorporation or other statutes require certain formalities — such as the execution of a formal subscription paper or the payment of a deposit by way of earnest — as conditions precedent to becoming for any purpose an actual share-

Hussey v. Manufacturers' Bank, 10 Pick. (Mass.) 415, 422 (headnote inadequate); *Manchester St. Ry. Co. v. Williams*, 71 N. H. 312, 317 (headnote inadequate); 52 Atl. 461; *Welch v. Gillelen*, 82 Pac. 248; 147 Cal. 571 (where a statute declared all persons shareholders whose names appeared on the register); *Union Nat. Bank v. Scott*, 53 N. Y. App. Div. 65; 66 N. Y. Supp. 145 (where *ratio decidendi* was that a statute making the stock-book *prima facie* evidence should not have the effect of making it conclusive evidence).

¹ "An offer to become a shareholder, when accepted by or on behalf of the members of the company, constitutes the offerer a shareholder." 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 46.

Accord: *Smith v. Gower*, 63 Ky. 17; *Wemple v. St. Louis, etc. R. R. Co.*, 120 Ill. 196; 11 N. E. 906; *Spear v. Crawford*, 14 Wend. (N. Y.) 20, 24-25; 28 Am. Dec. 513.

Cf. *Butler University v. Scoonover*, 114 Ind. 381; 16 N. E. 642; 5 Am. St. Rep. 627; *Nickum v. Burkhardt*, 30 Oreg. 464; 47 Pac. 788; 48 Pac. 474; 60 Am. St. Rep. 822; *Flour City Nat. Bank v. Shire*, 88 N. Y. App. Div. 401; 84 N. Y. Supp. 810; affirmed short, 179 N. Y. 587; 72 N. E. 1141; *Acadia Loan Corp. v. Wentworth*, 40 Nova Scotia 525.

In *Busey v. Hooper*, 35 Md. 15, 31; 6 Am. Rep. 350, the court said, "None of the cases decide that the mere fact of subscribing to the stock of an incorporated company constitutes the subscriber a stockholder, but that such subscription puts it in his power to become a stockholder, by compelling the corporation to give him the legal evidence of his being a stockholder, upon his complying with the terms of the subscription."

² *Burr v. Wilcox*, 22 N. Y. 551.

³ *Busey v. Hooper*, 35 Md. 15; 6 Am. Rep. 350.

holder as distinguished from one who has merely agreed to become a shareholder.¹

§ 174. **Payment for Shares not necessary before Subscriber can become a Shareholder.** — It goes without saying that, in general, payment for the shares subscribed for is not necessary in order that the subscriber may become a shareholder.² Indeed, frequently in England and sometimes in the United States, corporations carry on business for years although only a fraction of the nominal value of their outstanding shares has been paid in. On the other hand, where an established corporation increases its capital, some courts have held that the subscribers for the new shares do not become members of the corporation until actual payment therefor.³ Perhaps the best rule is that in each case it is a question of intention (subject to any formal requirements, such, for example, as the requirement of entry on the register of members); and that much slighter evidence of an intention that shares should not be deemed to be issued until paid for would be required in the case of shares of an increase of capital than in the case of the original or formative shares. It is difficult to say that as an unbending rule of law, new shares created by way of increase of capital can never be issued until paid for.⁴ At all events, in England there is certainly no such rule, as many cases attest in which no point of the kind was raised or thought of.

¹ *Charlotte, etc. R. R. Co. v. Blakely*, 3 Strob. (S. Car.) 245. See also *infra*, § 200.

Cf. *East Gloucestershire Ry. Co. v. Bartholomew*, L. R. 3 Ex. 15.

² *Downing v. Potts*, 23 N. J. Law 66; *Mass. Iron Co. v. Hooper*, 7 Cush. (Mass.) 183, 188 (headnote inadequate); *Curry v. Scott*, 54 Pa. St. 270; *Waukon, etc. R. R. Co. v. Dwyer*, 49 Iowa 121, 125; *Smith v. Burns Boiler & Mfg. Co.* (Wisc.), 111 N. W. 1123, 1127 (semble).

But see *Chase v. Sycamore, etc. R. R. Co.*, 38 Ill. 215, 218; *Coleman v. Spencer*, 5 Blackf. (Ind.) 197.

In some American states, statutes forbid the issue of shares except for money, property, etc., actually received. See *infra*, § 798.

As to whether a shareholder can require the company to issue a share certificate before he has paid in full, see *infra*, § 513.

³ *Baltimore City Pass. Ry. Co. v. Hambleton*, 77 Md. 341; 26 Atl. 279.

⁴ Cf. *infra*, § 591. See also *Booth v. Campbell*, 37 Md. 522 (declaring that subscriber to shares of increased stock is subject to a statutory liability to creditors before payment in full).

§ 175. **When Issue of Shares becomes equivalent to Payment of Value by Company.** — The issue of shares is a valuable consideration, and may therefore entitle the company to the rights of a purchaser for value as to any property transferred in payment of the shares.¹ In one case, however, it was held that inasmuch as the company may cancel the shares so long as they remain in the hands of the original allottee in case of failure of title to the property transferred in payment, therefore the company could not occupy the position of a *bona fide* purchaser for value of that property unless the shares had been transferred by the allottee.² The issue of the shares, it was said, was no more the payment of value than the giving of the company's note would have been. The analogy, however, is far from complete; since an issue of shares is more nearly equivalent to an assignment of property than to the creation of a mere obligation.

§ 176. **Allotment of Shares.** — The term allotment is often used in connection with the issue of shares, not infrequently without any accurate understanding of its meaning. The word properly denotes an acceptance by the corporation of an offer to take a definite number of its shares.³ For instance, a person applies to the company for, say, one hundred shares or such smaller number as may be granted to him. The directors reply, saying that they accept his offer for one hundred shares and agree to issue them to him. Their action is an allotment of the shares — an appropriation of a definite number of shares for a particular applicant.⁴ An allotment does not necessarily in-

¹ *Whittle v. Vanderbilt Mining Co.*, 83 Fed. 48; *Frenkel v. Hudson*, 82 Ala. 158; 2 So. 758; 60 Am. St. Rep. 736.

² *Wyeth v. Renz-Bowles*, 66 S. W. 825; 23 Ky. Law Rep. 2337.

³ The term is also sometimes used in America to denote the apportionment of the stock of a corporation among subscribers whose subscriptions exceed in aggregate amount the authorized capital. See, for an example, 1 Morawetz on Priv. Corps., 2d ed., § 58.

For other instances of uses of the word in a different sense from that defined above, see *Re Barber*, 15 Jur.

51; *Lake Superior Navigation Co. v. Morrison*, 22 Up. Can. C. P. 217.

⁴ "There is no difference, as has been often pointed out, between a contract to take shares and any other contract. What is termed 'allotment,' is generally neither more nor less than the acceptance by the company of the offer to take shares. To take the common case, the offer is to take a certain number of shares, or such a less number of shares as may be allotted. That offer is accepted by the allotment either of the total number mentioned in the offer or a less number to be taken by the person who made the

clude any entry on the company's books; and even if an entry is made, the entry on the books is not the allotment. The acceptance of the applicant's offer is the allotment, and like any other acceptance is not complete or effective until communicated in some way to the offerer.¹ There may be an allotment without specifying the distinguishing numbers of the allotted shares, even where as in Eng and every share has its own denoting number.² The term is not equivalent to "issue:" shares may be allotted before they are issued.³ Indeed, an allotment is more properly a promise to issue than an actual issue of shares. Of course, however, the shares may be issued immediately after the allotment or perhaps even simultaneously therewith. And in those of the United States in which a mere mutual agreement between the corporation and an applicant for shares that the relationship of shareholder and company shall thenceforth subsist between them is sufficient to constitute the applicant an actual shareholder without further ceremony, the mere allotment, completing as it does the contract between the parties, may be enough to establish the relationship. Nevertheless, that effect is accidental, and is not an essential part of the allotment.

§ 177. **When Shares may be allotted and issued — When Business may be commenced.** — The right of a company to perfect a regular permanent organization by the issue of shares

offer. This constitutes a binding contract to take that number according to the offer and acceptance. To my mind, there is no magic whatever in the term 'allotment' as used in these circumstances. It is said that the allotment is an appropriation of a specific number of shares. It is an appropriation, not of specific shares, but of a certain number of shares. It does not, however, make the person who has thus agreed to take the shares a member from that moment; all that it does is simply this — it constitutes a binding contract under which the company is bound to make a complete allotment (sic) of

the specified number of shares, and under which the person who has made the offer and is now bound by the acceptance is bound to take that particular number of shares." Per Chitty, J., in *Florence Land Co.*, 29 Ch. D. 421, 426. "The term 'allotment' is a popular term; it is not a technical term occurring in the Act of Parliament itself." *Id.*, p. 427.

¹ See *infra*, § 186.

² *Adams' Case*, 13 Eq. 474, 483.

Cf. *National Ins. Co. v. Egleson*, 29 Grant (Can.) 406.

³ *Clarke's Case*, 8 Ch. D. 635; *Thomson's Case*, 4 De G. J. & S. 749.

Cf. *East Gloucestershire Ry. Co. v. Bartholomew*, L. R. 3 Ex. 15.

must be distinguished from the right to commence business. In the absence of some regulation to the contrary by statute or otherwise, a corporation may organize by the allotment and issue of shares immediately upon the registration of the incorporation paper or as soon thereafter as persons can be found willing to accept the shares.

Statutes sometimes require additional conditions to be complied with before the company may begin business. Such conditions, although conditions precedent to the right to commence business, are merely conditions subsequent to incorporation. As such, breach is ordinarily no more than a cause of forfeiture to be taken advantage of by the state alone.¹ One such condition has been thought to be implied from the very nature of a corporation having a fixed capital, namely, that the entire capital of the company be subscribed. To be sure, in England, a company may, except so far as expressly restrained by statute,² commence business immediately upon its organization notwithstanding the fact that its capital has not been fully subscribed and in spite of the opposition of a minority shareholder.³ In America, a company may, as in England, allot and issue shares before the authorized capital has been completely subscribed,⁴ and may even begin business by unanimous consent or in pursuance of a provision in the incorporation paper;⁵ but it is generally thought that except under such circumstances, a corporation with a fixed limited capital has no right to commence business before all its shares are taken,⁶ so that any shareholder might enjoin the trans-

¹ *Hammond v. Straus*, 53 Md. 1, 14-15. See also *infra*, § 265. But cf. *Burns v. Beck, etc. Co.*, 83 Ga. 471; 10 S. E. 121.

² The Companies Act of 1900, 63 & 64 Vict., c. 48, § 4, requires certain rather burdensome conditions to be met before the first allotment can take place, and if an allotment is made in violation of these conditions, an allottee may have his name stricken from the register and his deposit returned. Cf. *Mears v. Western Canada Pulp Co.* (1905), 2 Ch. 353; *Finance & Issue v. Canadian Produce Corp.* (1905), 1 Ch. 37.

³ *MacDougall v. Jersey Hotel Co.*,

2 Hem. & Mill. 528. But cf. *Elder v. New Zealand Co.*, 30 L. T. 285.

See also *infra*, § 754, and *Laugier v. Victorian, etc. Power Co.*, 16 Vict. L. R. 64.

⁴ 1 Morawetz on Priv. Corps., 2d ed., § 57.

⁵ *Sweney Bros. v. Talcott*, 85 Iowa 103; 52 N. W. 106; *Nichols v. Burlington, etc. Plank Road Co.*, 4 G. Greene (Iowa) 42.

⁶ 1 Morawetz on Priv. Corps., 2d ed., § 408. But see *Johnson v. Kessler*, 76 Iowa 411; 41 N. W. 57; *Fayetteville, etc. Ry. v. Aberdeen, etc. R. R. Co.* (N. Car.) 55 S. E. 345; *Newcastle, etc. Turnpike Co. v. Bell*, 8 Blackf. (Ind.) 584.

action of any business. This doctrine is indeed the basis of the all but universal American rule prohibiting any calls upon shareholders before the authorized capital is fully taken.¹ This American rule, requiring that all the shares be subscribed before the company commences business, is not affected by a statutory provision authorizing the company to commence business as soon as the incorporation paper is filed; for such a provision is construed to mean that the company may begin business if otherwise qualified.²

§ 178. **First Meeting of Corporation.** — The first or organization meeting of a corporation is of much less importance where the company is formed under a general law than under a special act, which must be accepted before corporate existence commences. In the latter case, the corporation comes into being at that meeting, while in the former, the meeting would not seem to differ greatly in kind from any other meeting of the members of an existing company. For instance, a failure to give due notice of the first meeting to all entitled to such notice will not, where the company is being organized under a general law, vitiate the corporate existence, at least as against one who participated in the proceedings;³ and failure to give a formal notice prescribed by statute is quite immaterial where all the subscribers waive the statutory notice.⁴ Whilst the organization meeting of a company incorporated under modern general incorporation laws is not the equivalent of the meeting of the incorporators of a company incorporated by special act held for the purpose of accepting the charter, so that the cases which hold that acceptance of a special act of incorporation must take place within the company's home state⁵ are distinguishable; nevertheless, the

¹ *Infra*, § 754.

² *Livesey v. Omaha Hotel Co.*, 5 Nebr. 50 (headnote inadequate). Cf. *Masonic Temple Ass'n v. Channell*, 43 Minn. 353, 354; 45 N. W. 716.

³ *Nickum v. Burkhardt*, 30 Oreg. 464; 47 Pac. 788; 48 Pac. 474; 60 Am. St. Rep. 822.

Cf. *Packard v. Old Colony R. R. Co.*, 168 Mass. 92; 46 N. E. 433; *Walworth v. Brackett*, 98 Mass. 98.

As to how a meeting of corpora-

tors can be legally convened, see *supra*, § 166, and *infra*, § 1466.

⁴ *J. W. Butler Paper Co. v. Cleveland*, 220 Ill. 128; 77 N. E. 99.

⁵ *Miller v. Ewer*, 27 Me. 509; 46 Am. Dec. 619; *Camp v. Byrne*, 41 Mo. 525 (semble); *Freeman v. Machias Water, etc. Co.*, 38 Me. 343; *Smith v. Silver Valley Mining Co.*, 64 Md. 85; 20 Atl. 1032; 54 Am. Rep. 760.

But see *Heath v. Silverthorn, etc. Co.*, 39 Wisc. 146.

first or organization meeting of any corporation undoubtedly performs a corporate function in the strictest sense of the word and therefore, according to the prevailing rule, cannot be held in a foreign state.¹

§ 179-§ 260. AGREEMENTS TO TAKE SHARES.

§ 179. **Scope of Treatment.** — The matter of agreements to take shares has been the subject of a vast deal of litigation, and has received elaborate and, on the whole, full and satisfactory treatment at the hands of text-writers. Consequently, an exhaustive consideration of this topic is unnecessary here. Suffice it to give a general outline of the law, pursuing a somewhat different scheme and approaching the subject from a somewhat different side from the well-known American treatises, making particular reference to those points which have received hitherto but scant attention in this country.

§ 180. **The Name, "Subscriptions" — Nature of Agreements — distinguished from Act of becoming a Shareholder and from Agreements for Purchase.** — Agreements to take shares, especially in America, are often called subscriptions to shares or subscriptions to stock. The word "subscription" in that connection must not be taken literally; for it denotes any agreement to take shares whether made by signing or subscribing some document or otherwise.² It has been said that an agreement to "subscribe" for shares means, not that the subscriber will necessarily take the shares himself, but that he will either take them or find some one else to take them.³ The term subscription to shares is sometimes used to denote the so-called contract of membership in a corporation — that is, the act of becoming a

¹ *Duke v. Taylor*, 37 Fla. 64; 19 So. 172; 53 Am. St. Rep. 232; 31 L. R. A. 484 (where the supposed corporators were held liable as partners; *sed quære*, was this correct?). For explanation of this case, see § 1212 note.

As to the meaning of the terms "subscribe for" and "agree to take" with reference to shares, see further *Sagory v. Dubois*, 3 Sandf. (N. Y.) 466; *Cheraw, etc. R. R. Co. v. White*, 14 S. Car. 51.

Upon the whole subject, cf. *infra*, § 1212.

² *Henderson v. Lacon*, 5 Eq. 249 (semble); *Nugent v. Supervisors*,

Corp., 77 L. T. 146.

³ *London & Colonial Finance*

member rather than a contract to become a member.¹ This usage is probably in large measure due to the fact, which has already been mentioned, that in America no formality is, in general, necessary in order to become a member of a corporation. The usage is, however, apt to lead to confusion. For it is important to discriminate sharply between a contract to become a member and the act of becoming a member. It is the same difference as that between an executory contract of sale and a present transfer of title or between a contract to marry and a marriage.

Moreover, a contract to take shares must be distinguished from a contract to purchase shares.² On principle, it seems clear that a corporation cannot agree to *sell* its own unissued shares,³ although it may sell shares which have once been issued and which by forfeiture, surrender, or otherwise have reverted in it.

§ 181. **Classification of Agreements to take Shares — Scheme of Treatment.** — Agreements to take shares may be divided into three classes: first, agreements entered into prior to the incorporation of the company otherwise than by signing its memorandum of association or incorporation paper; second, agreements entered into by subscribing the incorporation paper; and, third, agreements made after incorporation. These three classes will be considered in reverse order, because the last mentioned class is the simplest, and is governed by rules of law more nearly approximating the ordinary principles of the law of contracts than is either of the other classes. In dealing with the other two

¹ E. g. 2 Clark & Marshall on Priv. Corps., § 442.

² *Wemple v. St. Louis, etc. R. R. Co.*, 120 Ill. 196; 11 N. E. 906; *Ottawa, etc. R. R. Co. v. Black*, 79 Ill. 262; *Lincoln Shoe Mfg. Co. v. Sheldon*, 44 Nebr. 279; 62 N. W. 480.

Cf. *Otter v. Brevoort Petroleum Co.*, 50 Barb. (N. Y.) 247; *Humaston v. Telegraph Co.*, 20 Wall. 20, 29 (declaring that in the case of a contract by a company to *sell* its own shares it may go into the market and buy shares to transfer to the purchaser).

³ Cf. *People v. Duffy-McInnery*

Co., 106 N. Y. Supp. 878 (holding that an original issue of shares is not subject to a tax as a "sale" of stock).

But see *Clark v. Continental Imp. Co.*, 57 Ind. 135. Cf. *Bates v. Great Western Tel. Co.*, 134 Ill. 536; 25 N. E. 521.

Certainly, the subscription to or purchase of shares, even preferred shares, cannot be regarded as in the nature of a loan or advance; *Grover v. Cavanaugh* (Ind.), 82 N. E. 104 (holding that oral representations as to the financial condition of the company are actionable notwithstanding Lord Tenterden's Act).

classes of agreements, it will be necessary to advert only to their peculiarities — to the points in which they differ from agreements made after incorporation.

§ 182-§ 238. *AGREEMENTS MADE AFTER INCORPORATION.*

§ 182. *Application of general Principles of Law of Contracts and of Agency.* — In general, agreements to take shares in a corporation already formed are governed by the same principles as other contracts in respect to offer and acceptance, consideration, and similar matters.¹ Indeed, it so happens that many of the leading English cases upon that branch of the law of contracts have had to do with agreements to take shares in corporations. So too, the law of agency applies to contracts to take shares in a company.²

§ 183. *Which Party to be deemed the Offerer.* — The offer may in theory be made by either party — either by the company or by the intended shareholder. In practice, the contract is usually made by the company's acceptance of an offer or application made by the person who is to take the shares. Indeed, the company is rarely the offerer except in cases where on an increase of capital the new shares are offered to the old shareholders in proportion to their former holdings, or in cases where the company in purporting to accept an offer of an applicant for shares introduces, perhaps inadvertently, some new term, so that the supposed acceptance is in legal effect a counter offer. To be sure, corporations often solicit subscriptions to their capital; but such solicitations are not in law offers which may be accepted by anybody who desires so to do,³ but are rather advertisements for offers. And even where a corporation offers a definite number of shares to a particular person, the transaction will if possible be construed as a mere solicitation for an offer to take so many shares.⁴

¹ See *supra*, p. 158 note 4.

² See *infra*, § 201.

³ But see *Greer v. Chartiers Ry. Co.*, 96 Pa. St. 391, 42 Am. Rep. 548.

⁴ Cf. *Re Barber*, 15 Jur. 51; *Wallace's Case* (1900), 2 Ch. 671

(stated *infra*, p. 170 note 3).

§ 184-§ 191. CASES WHERE THE OFFER IS MADE BY THE SUBSCRIBER.

§ 184-§ 189. *Acceptance of Offer, or Allotment.*

§ 184. **In general.** — As shown above, the company's acceptance of an application for shares by an intended shareholder is what is known as an allotment of shares.¹ This acceptance is like any other acceptance; and must be of precisely what was offered. For example, an application to take a definite number of shares cannot be accepted by the allotment of any less number;² and for this reason, applications are frequently made for a certain number of shares or such less number as may be allotted. Likewise, an application for paid-up shares cannot be accepted by an allotment of shares not fully paid.³ So, an application for £20 shares cannot be accepted by the allotment of an equivalent amount in £40 shares;⁴ and an offer to take shares to be issued by way of increase of capital cannot be accepted by an allotment of shares in the original capital of the company.⁵ Indeed, any new term sought to be introduced in the acceptance vitiates it. Thus, where the letter of allotment stated that unless payment for the shares should be made on the day named for payment in the application the shares would be forfeited, the supposed acceptance added to the term of the offer so that there was no completed contract.⁶ *A fortiori*, an application for shares on the terms that £2 per share shall be paid on allotment is not accepted by letter of allotment which states that payment of the allotment money must be made before a certain date;⁷ the argument that the naming of the date merely fixed a reasonable time and so did not depart from the offer did not prevail with the court.

¹ Supra, § 176. Of course, the applicant is not bound until allotment. Infra, § 190.

² Cf. *Ex parte Roberts*, 1 Drewry 204.

³ *Wynne's Case*, 8 Ch. 1002. Cf. infra, § 233, § 778, § 789.

⁴ *Gustard's Case*, 8 Eq. 438.

⁵ *Stephens v. Follett*, 43 Fed. 842.

Cf. *Bailey v. Tillinghast*, 99 Fed. 801, 811; 40 C. C. A. 93 (where the subscriber was held estopped by his

laches in not making a prompt objection to the allotment); *Rand v. Columbia Nat. Bank*, 94 Fed. 349; 36 C. C. A. 292 (same point as last case).

⁶ *Addinell's Case*, 1 Eq. 225; *Jackson v. Turquand*, L. R. 4 H. L. 305.

Cf. *Oriental, etc. Steam Co. v. Briggs*, 4 De G. F. & J. 191.

⁷ *Pentelow's Case*, 4 Ch. 178.

§ 185. **Written Offer as affected by Parol Qualifications.** — On the other hand, a written application may be accepted as it stands, an oral qualification thereof being disregarded;¹ but where the qualification is contained in a writing which accompanies the formal written application, the accompanying qualification is part of the offer, so that an attempted acceptance rejecting the qualification is nugatory.² Moreover, a written application delivered to a third person as an escrow or subject to a parol condition cannot be accepted until the condition is performed.³

§ 186. **Allotment incomplete until made known to Applicant.** — An allotment of shares, being an acceptance of an offer, is, like other acceptances, incomplete until communicated to the offerer.⁴ Hence, although the company may vote to accept the application and may even place the applicant's name on the register of shareholders, yet if notice of the allotment be not communicated to the applicant, he will not be bound.⁵ Of course, notice of the allotment given to an agent of the applicant authorized to receive the same is sufficient.⁶ An agent who is authorized to apply for shares is usually competent also to receive notice

¹ *Harrison's Case*, 3 Ch. 633.

Cf. *Scarlett v. Academy of Music*, 46 Md. 132.

² *Roger's Case*, 3 Ch. 633.

³ *Gilman v. Gross*, 97 Wisc. 224; 72 N. W. 885; *Ontario Ladies College v. Kendry*, 10 Ont. L. R. 324.

⁴ *Cozart v. Herndon*, 114 N. Car. 252; 19 S. E. 158; *Mallory's Case*, 3 Ont. L. Rep. 552.

An Illinois case holds that notice of the corporation's acceptance of an offer to take shares is not necessary. *Richelieu Hotel Co. v. International, etc. Encampment Co.*, 140 Ill. 248, 266; 29 N. E. 1044; 33 Am. St. Rep. 234. The case cannot have been very fully argued, since the court stated that no authority to the contrary had been cited.

Cf. *Bloxam's Case*, 33 Beav. 529; *New Albany, etc. R. R. Co. v. McCormick*, 10 Ind. 499; 71 Am. Dec. 337; *Burke v. Lechmere*, L. R. 6 Q. B. 297.

As to an agent of the company

accepting his own offer to subscribe to its shares, see *Greer v. Chartiers Ry. Co.*, 96 Pa. St. 391; 42 Am. Rep. 548.

As to whether notice of a call is sufficient notice of an acceptance of the application, see *Canadian Tin Plate Co.*, 12 Ont. L. R. 594.

⁵ *Gunn's Case*, 3 Ch. 40; *Ward's Case*, 10 Eq. 659; *Robinson's Case*, 4 Ch. 322; *Canadian Tin Plate Co.*, 12 Ont. L. R. 594, 638.

Cf. *Sahlgreen & Carrall's Case*, 3 Ch. 323; *Shackleford's Case*, 1 Ch. 567.

But see *Hawley v. Upton*, 102 U. S. 314 (note that this case came up on a certificate of division of opinion which did not specifically call upon the Supreme Court to answer the question whether notice of acceptance of the offer was necessary).

⁶ *Levita's Case*, 5 Ch. 489.

Cf. *De Rosaz's Case*, 21 L. T. 10.

of the acceptance of the application; ¹ but he is not necessarily so.² The delivery of a notice of allotment to a messenger to take to the allottee is not a sufficient communication of the offer.³ On the other hand, in accordance with the generally established rule as to acceptances of offers, where the application was made through the mails, the posting of a letter of allotment properly addressed makes the contract complete from that moment,⁴ even though the letter may never be received.⁵ Even if the letter of allotment is misdirected and consequently goes astray, yet if the error is due to the applicant's own fault, he cannot take advantage of the delay in receipt of notice of allotment in order to retract his offer.⁶ Where post-office regulations prohibit postmen from receiving letters to put into the mails, delivery of a letter of allotment to a postman for that purpose is not a posting thereof within the meaning of the general rule stated above.⁷ If the application contemplates not an allotment, or counter-promise, but the actual issue of shares as an act completing a unilateral contract, the applicant may be bound from the moment of the issue of the shares even before he receives notice thereof.⁸

§ 187. *Whether Notice of Allotment must be Direct and Formal.* — The acceptance of an application for shares must be communicated directly from the company to the applicant. It is not enough that the latter may obtain knowledge thereof indirectly. Yet the communication of the acceptance need not be formal or express. Anything emanating from the company which indicates to the applicant that the shares have been allotted to him will be sufficient.⁹ For example, although no formal notice of allotment be given, still if the shares applied for are issued to the applicant and he acts as shareholder, the contract of membership is complete.¹⁰ So, if the applicant is

¹ *Levita's Case*, 5 Ch. 489.

² *Robinson's Case*, 4 Ch. 322.

³ *Hebb's Case*, 4 Eq. 9.

⁴ *Harris's Case*, 7 Ch. 587.

⁵ *Household, etc. Ins. Co. v. Grant*, 4 Ex. D. 216; *Wall's Case*, 15 Eq. 18 (semble).

Contra: *Finucane's Case*, 17 W. R. 813 (overruled).

⁶ *Townsend's Case*, 13 Eq. 148.

⁷ *Ex parte Jones* (1900), 1 Ch. 220.

⁸ Perhaps, it is upon this ground that such cases as *Hawley v. Upton*, 102 U. S. 314, and *Richelieu Hotel Co. v. International, etc. Encampment Co.*, 140 Ill. 248, 266; 29 N. E. 1044; 33 Am. St. Rep. 234, which are cited above, p. 166 note 5, should be explained.

⁹ *Richards v. Home Assurance Ass'n*, L. R. 6 C. P. 591, 595.

¹⁰ *Levita's Case*, 3 Ch. 36; *Craw-*

present at the meeting of the directors when his application is accepted, no further communication of the acceptance is necessary.¹ So, where the ownership of a certain number of shares is made a qualification for a certain person's appointment to be a director or other officer, and where the candidate for the office accordingly applies for the requisite number of shares, notification of his appointment to the office may in some circumstances be a sufficient communication of the company's acceptance of the offer.²

§ 188. **Time for Acceptance or Allotment.** — An application for shares like any other offer must be accepted, if at all, within a reasonable time after the application,³ unless some other time be fixed by the applicant at which the offer shall expire.

§ 189. **Acceptance without any Entry on Company's Books.** — An acceptance of an offer to subscribe for shares need not be evidenced by any entry in the company's books but may rest in parol merely.⁴ As pointed out above, entry of the applicant's name on the register of shareholders, however necessary it may be in order to make him an actual shareholder, is not part of an allotment or acceptance of an offer to take shares, and is therefore not necessary in order to complete a binding executory contract on the one part to issue and on the other part to accept shares.⁵

§ 190. **Retraction of Offer to take Shares.** — An offer to take shares in a corporation may of course be retracted at any

ley's Case, 4 Ch. 322. These cases might also be supported on the ground of estoppel.

¹ *Fletcher's Case*, 17 L. T. 136.

² *Richards v. Home Assurance Ass'n*, L. R. 6 C. P. 591. But see *Carmichael and Hewett's Case*, 30 W. R. 742. Cf. *infra*, § 1414, et seq.

³ *Ramsgate Victoria Hotel Co. v. Montefiore*, L. R. 1 Ex. 109; *Carter, etc. Co. v. Hazzard*, 65 Minn. 432; 68 N. W. 74.

Cf. *Gregg's Case*, 15 W. R. 82 (where 13 months was held not to be an unreasonable time).

As to the necessity for prompt repudiation of the shares in order to escape liability because of unreasonable delay in allotment or notification of allotment, see *Boyle's Case*, 54 L. J. Ch. 550.

⁴ *Stuart v. Valley R. R. Co.*, 32 Gratt. (Va.) 146. As to the application of the Statute of Frauds, see *infra*, § 199.

⁵ As to statutes requiring contracts of subscription to shares to be in some particular form, see *infra*, § 200.

time before the acceptance is communicated, or posted, to the applicant, and *a fortiori* at any time before allotment; for until acceptance there is no contract.¹ This right of withdrawal is not affected by the fact that the applicant was also a director, and that, as such, his duty was to see that the offer, if advantageous for the company, should be promptly accepted.² The withdrawal is not complete until communicated to the company, but notice thereof given to the clerk in charge of the company's office is notice to the corporation.³ The retraction need not be express, or communicated directly to the corporation. For instance, the fact that an applicant for shares stops payment of a cheque given in payment of a deposit payable thereon is sufficient to charge the company with notice that the offer has been withdrawn.⁴ The retraction may be oral although the application was in writing.⁵

§ 191. **Offer or Promise to take Shares under Seal of Promisor.** — If a promise to take shares is made under the promisor's seal, and if the paper is delivered as his deed, it is binding forthwith, and cannot be revoked even before the company has accepted the proposition.⁶ In such a case, the allotment and issue of the shares constitute a condition which must be performed within a reasonable time in order to hold the promisor,⁷ but the applicant is bound beyond his power to escape, from the time of delivery of the document.

¹ *Wilson's Case*, 20 L. T. 962;

Miles' Case, 4 De G. J. & S. 471;

Gledhill's Case, 3 De G. F. & J. 713;

Wallace's Case (1900), 2 Ch. 671;

Thomson's Case, 34 L. J. Ch. 525;

Bristol Creamery Co. v. Tilton, 47

Atl. 591; 70 N. H. 239; *Canadian*

Tin Plate Co., 12 Ont. L. R. 594;

Essex Turnpike Corp. v. Collins, 8

Mass. 292; *Parker v. Northern Cent.*

Mich. R. R. Co., 33 Mich. 23;

Northern Cent. Mich. R. R. Co. v.

Ealow, 40 Mich. 222.

Cf. *Badger Paper Co. v. Rose*, 95

Wisc. 145; 70 N. W. 302; 37 L. R.

A. 162.

² *Ritso's Case*, 4 Ch. D. 774.

³ *Truman's Case* (1894), 3 Ch.

272.

⁴ *Truman's Case* (1894), 3 Ch.

272.

⁵ *Wilson's Case*, 20 L. T. 962;

Ritso's Case, 4 Ch. D. 774; *Tru-*

man's Case (1894), 3 Ch. 272. Cf.

Miles' Case, 4 De G. J. & S. 471.

⁶ *Nelson Coke Co. v. Pellatt*, 4

Ont. L. R. 481.

Cf. *Hudson Real Estate Co. v.*

Tower, 156 Mass. 82, 84; 30 N. E.

465; 32 Am. St. Rep. 434, stated

infra, § 242.

⁷ *Provincial Grocers, Ltd.*, 10 Ont.

L. R. 705.

§ 192-§ 196. *Cases where the Offer is made by the Company.*

§ 192. **Contract complete on Acceptance by Subscriber.** — Of course, where a corporation offers a certain number of shares to a certain person who thereupon accepts the offer, the contract is complete without any further "allotment" or acceptance on the part of the corporation.¹ But, as already stated, in doubtful cases the courts incline to hold solicitations of subscriptions to shares on the part of the corporation, by prospectuses and other similar means, as advertisements for offers rather than as offers.² It is not to be lightly assumed that a corporation intends to offer its shares to the first person who may apply for them without regard to his financial standing or desirability as a shareholder.

§ 193. **Offers of Shares to existing Shareholders pro rata.** — If a corporation offers new or additional shares to its own existing shareholders or to shareholders in a company which it is about to absorb, the offer is in general like any other offer looking to a bilateral contract;³ but it has some very striking peculiarities. For example, if one of the shareholders to whom such an offer is made dies before acceptance, the offer may be accepted by his executor.⁴ *A fortiori*, if the offer is made, nominally, to a shareholder who is deceased and whom the company knows to be dead, it may be accepted by his executor.⁵

§ 194. **Counter-Offer made by introducing new Terms in attempting to accept Application of Subscriber.** — If a company's ostensible acceptance of an offer of an applicant for shares introduces some new term not contained in the application, the supposed acceptance is, as stated above, a counter-offer which must be accepted by the original applicant before any completed contract arises. The acceptance of such a counter-offer is less

¹ *Greer v. Chartiers Ry. Co.*, 96 Pa. St. 391; 42 Am. Rep. 548; *Acadia Loan Corp. v. Wentworth*, 40 Nova Scotia, 525.

² See *supra*, § 183.

³ But cf. *Wallace's Case* (1900), 2 Ch. 671 (where it was held that an agreement for absorption of another corporation, containing a stipulation that the shareholders in the old company shall have at their election shares or bonds of the new company,

was not an offer which a shareholder in the old company could accept by mere notification of his election to take shares instead of bonds, but that the new company must notify him of an allotment of the shares in order to complete the contract between them).

⁴ *Cheshire Banking Co.*, 32 Ch. D. 301.

⁵ *Jackson v. Turquand*, L. R. 4 H. L. 305.

frequently express than implied from acquiescence. Mere inaction on the part of the allottee is not sufficient to create a contract. He made an application, which the company refused: the company's counter-proposition is a mere offer of which he is not bound to take notice, and of which acceptance must be affirmatively shown. Mere inaction or delay cannot amount to an acceptance of the company's counter-offer.¹ Hence, he is not bound to institute legal proceedings for the removal of his name from the register of shareholders, but is certainly protected if he promptly repudiate ownership of the shares.² A request that share-certificates be sent him was held in one case not to be sufficient evidence of acceptance of the company's offer, but merely to indicate a disposition to investigate what manner of shares had been offered him.³ The mere receipt and retention of share-certificates sent by the company does not amount to acceptance of the shares;⁴ for it is mere non-action. On the other hand, a letter acknowledging receipt of the certificates may be construed as an acceptance of the company's offer.⁵ Acting as shareholder will be deemed an acceptance of the shares;⁶ but the execution of a proxy to be used only in a certain contingency which never occurs will, it seems, have no such effect.⁷ Attendance at shareholders' meetings may be explained, if the attendance was not for the purpose of exercising rights as a shareholder but merely in order to watch the proceedings.⁸ Ordinarily, a transfer of the shares or any of them operates as an acceptance of the company's offer of them.⁹ But this would not be so where the transfer is made under the mistaken belief that the shares transferred were certain other shares for which the transferor had subscribed.¹⁰ The execution of a blank transfer at the time of the application, by means whereof a transfer of the shares is subsequently effected, has been held not to estop the applicant from denying

¹ *Wynne's Case*, 8 Ch. 1002.

Cf. *Wilson's Case*, 20 L. T. 962.

But see *Ex parte Perrett*, 15 Eq. 121.
250; *Wheatcroft's Case*, 42 L. J. Ch. 853.

² *Gorissen's Case*, 8 Ch. 507.

Cf. *Wilson's Case*, 20 L. T. 962.

³ *Beck's Case*, 9 Ch. 392.

But see *Hindley's Case* (1896), 2 Ch. 121.

⁴ *Somerville's Case*, 6 Ch. 266.

⁵ *Somerville's Case*, 6 Ch. 266.

⁶ *Hindley's Case* (1896), 2 Ch.

⁷ *Ticonic Water, etc. Co. v. Lang*, 63 Me. 480.

⁸ *Simpson's Case*, 4 Ch. 184.

⁹ Cf. *Crawley's Case*, 4 Ch. 322;
Railway Timetables Co., 42 Ch. D.

¹⁰ *Arnot's Case*, 36 Ch. D. 702.

that his offer was accepted by the company.¹ An allotment of shares to a person who has never applied for them at all would operate as an offer on the company's part to the same extent as an ostensible acceptance of an application which introduces some new term would do.

§ 195. **Time for Acceptance of Company's Offer.** — The company's offer must be accepted if at all within the time limited in the offer itself, or if no time be limited then within a reasonable time. It seems that if the company goes into liquidation before the offer has expired, the option may be accepted after the commencement of the liquidation,² and that upon such acceptance the acceptor becomes entitled to his *pro rata* share in the company's assets.

§ 196. **Application for Shares in Ignorance of Company's Offer not Acceptance.** — What is intended as an offer to take shares cannot be construed as an acceptance by the applicant of an offer previously made without his knowledge by the company. For example, where a corporation purports to allot shares to a person who had not applied for them, a subsequent application for the same number of shares made in ignorance of the previous attempted allotment cannot constitute a binding contract unless it be subsequently accepted by the company and unless such acceptance be communicated to the applicant.³

§ 197. **Implied Offers and Acceptances.** — There may be cases where either the offer or acceptance⁴ or both are implied rather than express.⁵ For example, where R as director signs

¹ *Ward's Case*, 10 Eq. 659.

² *Hirsch v. Burns*, 77 L. T. 377.

³ *Northern Electric Wire, etc. Co.*, 2 Megone 288. But cf. *United Ports, etc. Ins. Co.*, 20 W. R. 88.

⁴ Where D agreed that he and his partner should between them take 250 shares, and where D accordingly applied for 50 shares and his partner for 200, the court inferred an assent on the part of the company to this division of the 250 shares from the mere retention of the deposits paid on application,

although it was conceded that the acceptance or retention of a deposit would not be sufficient evidence of acceptance of an application not made in pursuance of a previous arrangement such as that stated: *Davies's Case*, 41 L. J. Ch. 659.

⁵ *Clevenger v. Moore* (N. J.), 58 Atl. 88; 71 N. J. Law 148; *Parkhurst v. Mexican, etc. R. R. Co.*, 102 Ill. App. 507; *Hecht, Liebmann & Co. v. Phoenix Woolen Co.*, 121 Fed. 188.

Cf. *Stephens v. Follett*, 43 Fed. 842.

the minutes of a directors' meeting at which he was present, and at which a list of supposed subscribers for shares (including himself) was read out, there is sufficient evidence of a completed though implied contract.¹ Somewhat similar instances of implied contracts to take shares may be found in cases relating to directors' qualification shares.² These cases of implied contract are sometimes thought to rest on estoppel;³ but the principle of estoppel is properly only an element in the implied contract.

§ 198. **Infants' Contracts to take Share.** — An infant's agreement to take shares in a corporation, like other contracts of an infant, is of course voidable even after the contract has been executed by entering his name on the register of shareholders.⁴ Where the infant has received no benefit from the contract, has attended no meetings of shareholders, and has received no dividends, he may during infancy repudiate the agreement and by next friend bring an action to recover the deposits paid on application and allotment.⁵ Unless, however, the infant on coming of age promptly repudiates the contract, he will be bound thereby even though he may never have acted as shareholder.⁶ The right of repudiation exists although the incorporation act may provide that "*every person* who shall have subscribed the prescribed sum . . . and whose name shall have been entered on the register of shareholders, . . . shall be deemed a shareholder"; the words quoted mean every person who shall have contracted to subscribe, and therefore do not include persons not *sui juris*.⁷ Where the infant is sued upon the contract, a plea of infancy is demurrable unless it allege that the defendant repudiated the shares;⁸ and this is true even though

¹ *Ex parte Roney*, 33 L. J. Ch. 731.

But cf. *Tothill's Case*, 1 Ch. 85.

² See *infra*, § 1414, et seq.

³ *Hays v. Pittsburgh, etc. R. R. Co.*, 38 Pa. St. 81; *Nugent v. Supervisors*, 19 Wall. 241. See 2 Clark & Marshall on Priv. Corps., § 515, pp. 1570-1573.

⁴ *Newry, etc. Ry. Co. v. Coombe*, 3 Ex. 565.

⁵ *Hamilton v. Vaughan, etc. Co.* (1894), 3 Ch. 589.

Cf. *White v. Mount Pleasant Mills Corp.*, 172 Mass. 462; *N. E.* 632.

⁶ *Ebbett's Case*, 5 Ch. 302.

Cf. *Yeoland Consols*, 58 L. T. 922; *Cork, etc. Ry. Co. v. Cazenove*, 10 Q. B. 935; *Hart's Case*, 6 Eq. 512 (where the infant was held entitled to repudiate three years after attaining majority).

⁷ *Newry, etc. Ry. Co. v. Coombe*, 3 Ex. 565; *North Western Ry. Co. v. McMichael*, 5 Ex. 114.

But see *Cork, etc. Ry. Co. v. Cazenove*, 10 Q. B. 935.

⁸ *North Western Ry. Co. v. McMichael*, 5 Ex. 114.

the ownership of the shares be burdensome rather than beneficial, at least unless the infancy be alleged to be still subsisting at the time of pleading.¹

§ 199. **Application of Statute of Frauds.** — It would seem clear that subscriptions to shares are not in any proper sense contracts of sale within the seventeenth section of the Statute of Frauds, and that accordingly they should not be required to be in writing in any jurisdiction in which the Statute of 29 Charles II c. 3 is in force in unmodified form,² and this, too, quite independently of the question whether shares of capital stock are "goods, wares and merchandise," within the meaning of that statute.³ In some of the American states, the original Statute of Frauds may have been so amended as to include agreements to take shares in a corporation, and sometimes incorporation acts require that subscription shall be in writing, in which case oral subscriptions will not be binding.⁴ Whether contracts for the sale or transfer of shares are within the seventeenth section of the statute is a different question.⁵

§ 200. **Statutes prescribing Forms or Ceremonies for Subscriptions to Shares.** — Where a statute prescribes certain forms to be gone through by subscribers to shares, compliance with the statutory ceremonies may well enough be a condition precedent to the attainment of the status of an actual shareholder,⁶ but the courts should struggle against any construction of the statute which would invalidate, on account of a failure to observe the statutory conditions, what would otherwise be a binding executory contract on the one part to issue and on the other part to accept shares.⁷ For example, where a statute requires the payment of a deposit from every subscriber at the time of subscribing, it may well enough be that no one can become an actual shareholder entitled to the rights and subject to the liabilities of a

¹ *North Western Ry. Co. v. McMichael*, 5 Ex. 114.

⁴ *Vreeland v. New Jersey Stone Co.*, 29 N. J. Eq. 188; *Fanning v.*

² *Webb v. Baltimore, etc. R. R. Insurance Co.*, 37 Oh. St. 339; 41 Co., 77 Md. 92; 26 Atl. 113; 39 Am. Am. Rep. 517.

St. Rep. 396; *Somerset Nat. Banking Co. v. Adams*, 72 S. W. 1125;

⁵ See *infra*, § 505.

24 Ky. Law Rep. 2083; *Rogers v. Burr*, 105 Ga. 432; 31 S. E. 438;

⁶ *New Brunswick, etc. Ry. Co. v. Muggeridge*, 4 H. & N. 580.

70 Am. St. Rep. 50; 2 Clark & Marshall on Priv. Corps., § 445 c.

⁷ Cf. *Buffalo, etc. R. R. Co. v. Chicory Co. v. Lednicky* (Nebr.),

³ As to this see *infra*, § 505.

113 N. W. 245.

shareholder until the statutory deposit be paid; but nevertheless it is submitted that non-payment of the deposit should certainly not vitiate the contract or prevent the one party from recovering damages from the other for a failure to issue the shares or to take and pay for them.¹ The decided cases on the subject do not, however, establish any intelligible, systematic rules, but consist in a wilderness of conflicting decisions.² For example, some cases hold that non-payment of a statutory deposit relieves the subscriber of any liability on the contract,³ but other cases hold the contrary.⁴ As such statutes are less common nowadays than formerly, the perplexing uncertainty and contrariety in the decisions need occasion the less regret.

§ 201. **Subscriptions through Agents.** — The general principles of the law of agency apply to contracts of subscription to a corporation's shares.⁵ Thus, such contracts are governed by the same law as other contracts in respect to the liability of an agent acting without or in excess of his authority,⁶ and in respect to rights of the parties where the contract is made by an agent for an undisclosed principal.⁷ Where an application for

¹ *Ashtabula, etc. R. R. Co. v. Smith*, 15 Oh. St. 328. As to ratification of contract made by unauthorized agent, see

² Cf. 2 Clark & Marshall on Priv. Corps., § 445; 1 Morawetz on Priv. Corps., § 71-§ 73. See also *infra*, § 796. *McClelland v. Whiteley*, 15 Fed. 322; *Levita's Case*, 5 Ch. 489; *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306 (headnote inadequate —

³ E. g. *Wood v. Coosa, etc. R. R. Co.*, 32 Ga. 273 (with which compare, however, *Mitchell v. Rome R. R. Co.*, 17 Ga. 574); *Hapgoods v. Lusch*, 107 N. Y. Supp. 331. ratification by payment of calls and failure to repudiate shares otherwise than by resisting an action for call).

⁴ E. g. *Vicksburg, etc. R. R. Co. v. McKean*, 12 La. Ann. 638; *Wight v. Shelby R. R. Co.*, 16 B. Monr. (Ky.) 4; 63 Am. Dec. 522; *Judah v. American Live Stock Ins. Co.*, 4 Ind. 333. ⁷ *Southampton, etc. Steam Boat Co.*, 4 De G. J. & S. 200; *State ex rel. Columbia Valley R. R. Co. v. Superior Ct.* (Wash.), 88 Pac. 332 (subscription by a person described as "trustee" without disclosure of name of principal or *cestui que trust*); *State ex rel. Biddle v. Superior Court* (Wash.), 87 Pac. 40 (a similar case, holding that either the principal or the "trustee" is liable).

Cf. *Taggart v. Western Md. R. R. Co.*, 24 Md. 563; 89 Am. Dec. 760.

⁵ Cf. *Farmers' & Mech. Bank v. Nelson*, 12 Md. 35 (where the contract was held not to be binding because the company's agent by whom it was made had exceeded his authority by failing to exact a deposit from the subscriber).

⁶ *Ex parte Panmure*, 24 Ch. D. 367.

But see *Hyslop v. Morrel Bros.*, W. N. (1891) 19.

Cf. *Ex parte Bugg*, 2 Drewry & Sm. 452 (where the relation was held to be that of trustee and *cestui que trust* and not that of agent and principal).

shares is made in the name of a married woman who is incapable of contracting and who signs the application at the instance of her father without knowing its contents or effect, and where the father intends to become the substantial owner of the shares, the case is assimilated to an application in the name of a fictitious person, so that the contract is regarded as made by the father under his daughter's name as an alias.¹

§ 202. **Subscriptions by Agent or Trustee for the Corporation itself.** — A subscription by a person as trustee or agent for the company itself would seem to be a nullity.² There must be at least two parties to a contract. Under some circumstances — for example, where the trustee or agent represents that the subscription is real and not colorable — he may be bound personally.³

§ 203. **Subscriptions by Executors.** — Ordinarily, a subscription by an executor binds him personally and not the estate of his decedent.⁴ But where a person who is executor subscribes for two sets of shares, the first individually, and the second as executor, there are, it has been held, two distinct contracts.⁵

§ 204—§ 219. SUBSCRIPTIONS PROCURED BY FRAUD OR MISREPRESENTATION.

§ 204. **Defence of Fraud in general — Laches of Subscriber.** — The only argument against holding that subscriptions to shares like other contracts may be avoided by the allottee on account of fraudulent misrepresentations practised upon him by agents of the company is that the creditors of the corporation — innocent third parties — have a vital interest in such subscriptions; that — to use a figure of speech familiar in America — the subscriptions to the capital of a corporation constitute a “trust-fund” for the payment of its debts. This argument is not sufficiently strong to justify the courts in altogether depriving the defrauded allottee of the defence.⁶ Nevertheless, it does sharply

¹ *Pugh and Sharsman's Case*, 13 v. *Grand Collier Dock Co.*, 11 Sim. Eq. 566. See also *infra*, § 767. 327; *Allibone v. Hager*, 46 Pa. St. Cf. *Nat. Commercial Bank v.* 48.

McDonnell, 92 Ala. 387; 9 So. 149. ⁴ See also *infra*, § 768.

² *Holladay v. Elliott*, 8 Oreg. 84. ⁵ *Erie, etc. R. R. Co. v. Patrick*,

³ *Johnston v. Allis*, 71 Conn. 207; 2 Keyes (N. Y.) 256. 41 Atl. 816 (distinguishing *Russell v. Bristol*, 49 Conn. 251); *Preston Co.*, 29 N. J. Eq. 188; *Blake's Case*,

differentiate agreements to take shares, when executed by actual issue of the shares, from other contracts. Accordingly, the law is settled on both sides of the Atlantic that a person who has been induced to take shares in a corporation by fraudulent misrepresentation loses the defence unless he repudiates the contract (and perhaps unless he follows up his repudiation by instituting a suit to be relieved of the shares) within a reasonable time after discovery of the fraud,¹ or after the fraud might, by the exercise of due diligence on his part, have been discovered.² However, if a material misrepresentation be proved, the contract is *prima facie* voidable so that the burden of establishing laches rests on the company.³ Failure promptly to rescind may be excused where the delay is due to a request of the company or its promoters.⁴ An attempt to repudiate liability on the shares for some cause other than the fraudulent misrepresentation in question will not negative the inference of laches arising from the delay in discovering the fraud and in repudiating the shares on that ground.⁵ The question whether the defrauded shareholder has used due diligence is in general a question of fact for the jury.⁶

§ 205. **English Rule requiring Repudiation of Shares and Institution of Proceedings for Removal of Name from Share-Register before Winding-up or Suspension of Business.** — In

34 Beav. 639; *Mulholland v. Wash- Walker*, 13 Nat. B. Reg. 82; *North- ington Match Co.*, 35 Wash. 315; *rop v. Bushnell*, 38 Conn. 498.

77 Pac. 497; *Stewart v. Rutherford*, Cf. *Duffield v. Barnum Wire, etc. Works*, 64 Mich. 293; 31 N. W. 310;

74 Ga. 435, and many other cases. *Hinkley v. Sac Oil, etc. Co.* (Iowa), 107 N. W. 629, 634 (where a good statement will be found of the degree of diligence required in suspecting and discovering fraud). But see *American Alkali Co. v. Salom*, 131 Fed. 46, 50-51; 65 C. C. A. 284.

But see *Howard v. Glenn*, 85 Ga. 238; 11 S. E. 610; 21 Am. St. Rep. 156; *Turner v. Grangers', etc. Ins. Co.*, 65 Ga. 649; 38 Am. Rep. 801.

¹ *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99; *Tait's Case*, 3 Eq. 795; *Ashley's Case*, 9 Eq. 263; *Sharpley v. South Ry. Co.*, 2 Ch. D. 663; *Re Shearman*, 66 L. J. Ch. 25; *Ogilvie v. Knox Ins. Co.*, 22 How. 380. See 2 Clark & Marshall on Priv. Corps., § 473 d.

² *Wilkinson's Case*, 2 Ch. 536; 45, 51-55. ³ *London & Staffordshire Fire Ins. Co.*, 24 Ch. D. 149.

⁴ *Cox v. National Coal, etc. Co.* (W. Va.), 56 S. E. 494. ⁵ *Upton v. Tribilcock*, 91 U. S.

⁶ *Newton Nat. Bank v. Newbegin*, 74 Fed. 135; 20 C. C. A. 339; 33 L. R. A. 727.

addition to this duty of diligence, the law in Great Britain imposes a somewhat arbitrary restriction on the defrauded shareholder's right of defence. In that country, it will be remembered, each company is required to keep a register of its members, which shall be open to inspection by shareholders and creditors; and when a winding-up commences all those persons whose names, with their consent, have been entered on that register must be placed on the "list of contributories." The commencement of the winding-up proceeding, according to the construction put by the British courts on the Companies Act, fixes forever the liabilities of these "contributories." Hence, a person who has been induced to take shares by fraud and whose name has been entered on the register of members, loses his defence unless prior to the winding-up he has instituted legal proceedings to have his name removed from the register; and this is true even though he did not discover the fraud and had no opportunity of discovering it prior to the commencement of the winding-up.¹ This is a technical and perhaps an arbitrary rule, founded upon the peculiar nature of winding-up proceedings under the English law.

Under this rule, it is not enough that the subscriber may have repudiated the contract before the winding-up; he must institute legal proceedings to have his name removed from the register.² It was once held not to be enough that he may have set up the defence of fraud against an action for calls;³ but recent cases hold that to be sufficient.⁴ It makes no difference, however, that the company's assets derived from other sources are sufficient to pay the debts in full so that the defrauded share-

¹ *Oakes v. Turquand*, L. R. 2 H. L. 325; *Kent v. Freehold Land Co.*, 3 Ch. 493. Cf. *Cocksedge v. Metropolitan, etc. Ass'n*, 64 L. T. 826.

² Cf. *Addlestone Linoleum Co.*, 37 Ch. D. 191. ³ *Etna Ins. Co.* (1871), Ir. Rep. 6 Eq. 298 (where the action for calls had been defeated on account of the fraud); *Cleveland Iron Co.*, 16 W. R. 95.

⁴ *Scottish Petroleum Co.*, 23 Ch. D. 413; *Ex parte Storey*, 6 Times L. R. 357; 62 L. T. 791. If such proceedings are instituted before the winding-up is begun, it is immaterial that the winding-up may have supervened before they are determined. *Reese River Mining Co. v. Smith*, L. R. 4 H. L. 64. ⁵ *Whiteley's Case* (1900), 1 Ch. 365; *Pakenham Pork Packing Co.*, 6 Ont. L. R. 582. But see *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306, 310 (as to a subscription to shares in an English company).

holder's liability is being enforced merely for the benefit of other shareholders.¹ If, however, one shareholder begins proceedings to compel the removal of his name from the register because of misrepresentation, an agreement between the company and other shareholders similarly situated that their claims for relief from the contract of membership shall abide the result of those proceedings, will entitle those shareholders to rescission of their contracts although the company may be wound-up prior to the decision of the test case;² but the mere fact that, without any such agreement, other shareholders having like cause to complain began proceedings for the removal of their names from the register is not enough. If, however, the company assents to the repudiation of the shares and strikes out the allotment, there is no occasion for legal proceedings, and consequently the allottee will be protected even though a winding-up supervenes;³ and this is true although the allotment is cancelled upon some ground other than the misrepresentation.⁴ Supervening insolvency of the company, coupled with a closing of its doors and suspension of business, will, it seems, have the same effect in preventing a shareholder from subsequently repudiating liability on the ground of fraud as the commencement of formal winding-up proceedings would have.⁵ These rules have no application where the shares have been declared forfeited by the company, and an action brought against the former shareholder to recover calls overdue at the time of the forfeiture; in such a case the former shareholder has become a mere debtor to the company, and like any other debtor may defend, even after the institution of liquidation proceedings, on the ground that the claim against him was obtained by the company's fraud, unless by laches or otherwise he had lost the right to set up this defence at the time of the forfeiture.⁶

§ 206. **American Rule as to Effect of Winding-up Proceedings on Defence of Fraud.** — In America, the courts, it is sub-

¹ *Burgess's Case*, 15 Ch. D. 507.

⁵ *Tennent v. City of Glasgow*

² *Pawle's Case*, 4 Ch. 497; *Scottish Petroleum Co.*, 23 Ch. D. 413 (semble).

Bank, 4 A. C. 615. Mere insolvency, without suspension of business, will not have that effect. *Ex parte Carl- ing*, 56 L. J. Ch. 321.

³ *Wright's Case*, 20 W. R. 45; 7 Ch. 55; *Fox's Case*, 5 Eq. 118. See also *infra*, § 637.

⁶ *Aaron's Reefs v. Twiss* (1896), A. C. 273. Cf. *infra*, § 828.

⁴ *Wright's Case*, 20 W. R. 45; 7 Ch. 55.

mitted, should not follow the English decisions in holding that the supervention of insolvency or of liquidation proceedings abruptly cuts short a shareholder's right of rescission on account of misrepresentation, irrespective of whether he had been guilty of laches in discovering the fraud or repudiating the shares. In this country, it would seem that after insolvency or the commencement of a suit for the winding-up of the company's affairs as well as before, the questions are whether the shareholder has used due diligence in discovering the fraud and in getting rid of the shares.¹ However this may be, it would seem clear that in America a defrauded subscriber to shares who has repudiated the contract before the known insolvency of the company and before the commencement of winding-up proceedings should not be debarred from relief because he may not have instituted a suit for rescission and removal of his name from the register of shareholders.²

§ 207. **Election to keep Shares notwithstanding Fraud or Misrepresentation.** — Even in a case where there has been no prolonged delay in repudiating the contract and in beginning proceedings to have one's name removed from the register of shareholders, or where such proceedings have actually been commenced, yet the shareholder to whom the misrepresentation was made may voluntarily elect to keep the shares and thus preclude himself from raising or persisting in the defence of fraud or misrepresentation.³ Any facts evincing an intention

¹ *Ogilvie v. Knox Ins. Co.*, 22 How. 380; *Newton Nat. Bank v. Newbegin*, 74 Fed. 135 (semble); *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313; 22 S. W. 719; *Kentucky Mutual, etc. Co. v. Schaefer* (Ky.), 85 S. W. 1098; 27 Ky. L. Rep. 657; *Dieterle v. Ann Arbor Paint, etc. Co.*, 107 N. W. 79; 143 Mich. 416; *Hinkley v. Sac Oil, etc. Co.* (Iowa), 107 N. W. 629.

But see *Howard v. Turner*, 155 Pa. St. 349; 26 Atl. 753; 35 Am. St. Rep. 883; *Howard v. Glenn*, 85 Ga. 238, 261; 11 S. E. 610; 21 Am. St. Rep. 156; *Scott v. Latimer*, 89 Fed. 843; 33 C. C. A. 1 (where the National Bank Act was in ques-

tion); *Wallace v. Hood*, 89 Fed. 11 (same point); *Marion Trust Co. v. Blish* (Ind.), 79 N. E. 415.

² *Fear v. Bartlett*, 81 Md. 435; 32 Atl. 322; 33 L. R. A. 721; *Newton Nat. Bank v. Newbegin*, 74 Fed. 135; 20 C. C. A. 339; 33 L. R. A. 727; *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313, 22 S. W. 719; *Savage v. Bartlett*, 78 Md. 561; 28 Atl. 414.

But see *Howard v. Glenn*, 85 Ga. 238; 11 S. E. 610; 21 Am. St. Rep. 156; *Turner v. Grangers', etc. Ins. Co.*, 65 Ga. 649; 38 Am. Rep. 801; *Howard v. Turner*, 155 Pa. St. 349; 26 Atl. 753; 35 Am. St. Rep. 883 (ruling on plaintiff's second "point").

³ *Wilson v. Hundley*, 96 Va. 96;

to retain ownership of the shares after learning of the fraud will have that effect — such as payment of calls,¹ voting at shareholders' meetings,² receiving dividends,³ attempting to sell the shares,⁴ etc. Doing these things will not, however, deprive the shareholder of the defence unless he had previously discovered the misrepresentation.⁵ Moreover, the fact that a defrauded allottee has trafficked in other shares in the same company will not preclude him from rescinding the fraudulent contract.⁶ Moreover, the fact that the shareholder has repudiated the contract on some ground other than that of fraud will not preclude him from subsequently setting up the defence of fraud.⁷

§ 208. **Necessity for returning Shares to Company.** — An allottee of shares cannot rescind the contract because of fraud unless he is in a position to place the company in *statu quo* by surrendering the shares.⁸ Hence, if a person is induced by fraud to take shares in an unincorporated association, his assent to its becoming incorporated, so that the shares in the unincorporated association cease to exist and consequently cannot be restored on rescission of the contract, will prevent him from rescinding the subscription on account of the fraud.⁹ Similarly, if the defrauded allottee transfers the shares to his infant

30 S. E. 492; 70 Am. St. Rep. 837; *Franey v. Wauwatosa Park Co.*, 99 Wisc. 40; 74 N. W. 548.

¹ See *Whitehouse's Case*, 3 Eq. 790; *Re Shearman*, 66 L. J. Ch. 25; *Marten v. Burns Wine Co.*, 99 Cal. 355; 33 Pac. 1107.

Cf. *Fear v. Bartlett*, 81 Md. 435; 32 Atl. 322; 33 L. R. A. 721.

² *Foulkes v. Quartz Hill, etc. Mining Co.*, Cababé & Ellis, 156; *Marten v. Burns Wine Co.*, 99 Cal. 355; 33 Pac. 1107.

Cf. *Ogilvie v. Knox Ins. Co.*, 22 How. 380, 391 (headnote inadequate).

But see *Tomlin's Case* (1898), 1 Ch. 104. Mere attendance at a meeting without voting has been held not to be a condonation of the misrepresentation. *Ex parte Edwards*, 64 L. T. 561. Cf. *Maine v. Midland Investment Co.* (Iowa), 109 N. W. 801.

³ *Scholey v. Central Ry. Co.*, 9 Eq. 266 n.

⁴ *Ex parte Briggs*, 1 Eq. 483.

⁵ *Mount Morgan Gold Mine*, 3 Times L. R. 556.

⁶ *Mulholland v. Washington Match Co.*, 35 Wash. 315; 77 Pac. 497.

⁷ *Alabama Foundry, etc. Works v. Dallas*, 29 So. 459; 127 Ala. 513.

⁸ Cf. *Maine v. Midland Investment Co.* (Iowa), 109 N. W. 801.

As to whether the defrauded subscriber is bound to return the identical shares issued to him or whether it is enough to return an equal number of the same class of shares, cf. § 501.

⁹ *Western Bank v. Addie*, L. R. 1 H. L. (Sc.) 185. As to the effect of assenting to a reorganization scheme, cf. *Spreckels v. Gorrill* (Cal.), 92 Pac. 1011.

children, he puts it out of his power to return them, and is therefore precluded from rescinding on the ground of the fraud.¹ The fact, however, that in ignorance of the fraud a shareholder has sold some of the shares which he was induced to take will not prevent him from repudiating the contract so far as the shares remaining under his control are concerned.² In order to rescind for fraud or misrepresentation, the allottee must offer to restore any dividends that may have been paid to him.³

§ 209. **Defence of Fraud available either at Law or in Equity.** — The defence that a contract to take shares in a corporation was procured by the fraud of the company, when available to the shareholder at all, is good at law as well as in equity;⁴ but the better practice is to file a bill in equity for rescission of the contract of subscription.⁵ The defrauded shareholder is not precluded from asking equitable intervention because the shares may have been issued at a discount.⁶

§ 210. **Recovering back Money paid in on the Shares.** — Upon rescission of an allotment of shares on account of misrepresentation, the allottee is entitled to recover from the company any sums he may have paid on the shares, by way of deposits on application or allotment, or otherwise,⁷ with interest thereon.⁸ The decree for such repayment may go against the

¹ *Francis v. New York, etc. R. R. Co.*, 108 N. Y. 93; 15 N. E. 192.

² *Mount Morgan Gold Mine*, 3 Times L. R. 556. Cf. *American Alkali Co. v. Salom*, 131 Fed. 46, 49-50; 65 C. C. A. 284.

³ *Wallace v. Hood*, 89 Fed. 11, 15 (headnote inadequate); *Marten v. Burns Wine Co.*, 99 Cal. 355; 33 Pac. 1107.

⁴ *Bulch-y-Plum Mining Co. v. Baymes*, L. R. 2 Ex. 324; *American Alkali Co. v. Salom*, 131 Fed. 46, 50; 65 C. C. A. 284.

⁵ *Mack v. Latta*, 178 N. Y. 525; 71 N. E. 97; 67 L. R. A. 126 (joining claim for damages against the directors for deceit); *Manning v. Berdan*, 135 Fed. 159; *Sherman v. Am. Stove Co.*, 85 Mich. 169; 48 N. W. 537 (where two shareholders united in a single suit for rescission);

Bosher v. R. & H. Land Co., 89 Va. 455; 16 S. E. 360; 37 Am. St. Rep.

879 (similar point to that of last case). Cf. *Barcus v. Gates*, 89 Fed. 783; 32 C. C. A. 337; *Negley v. Hagerstown Mfg. Co.*, 86 Md. 692; *Tyler v. Savage*, 143 U. S. 79.

But see *Dorsey Machine Co. v. McCaffrey*, 139 Ind. 545; 38 N. E. 208; 47 Am. St. Rep. 290.

⁶ *Barcus v. Gates*, 89 Fed. 783; 32 C. C. A. 337.

⁷ *Karberg's Case* (1892), 3 Ch. 1; *Grangers' Ins. Co. v. Turner*, 61 Ga. 561; *Ramsey v. Thompson Mfg. Co.*, 116 Mo. 313; 22 S. W. 719.

Cf. *Stewart v. Austin*, 3 Eq. 299; *Stewart v. Rutherford*, 74 Ga. 435.

⁸ *Ex parte Wainwright*, 59 L. J. Ch. 281; *McClanahan v. Ivanhoe Land, etc. Co.*, 96 Va. 124; 30 S. E. 450.

individual officers or agents who participated in the fraud as well as against the corporation itself.¹

§ 211. **Fraud practised on original Subscriber no Defence to Transferee.** — The defence that a subscription was induced by fraud is personal to the defrauded subscriber and cannot be set up by a transferee.² On the other hand, the mere fact that a subscriber may have paid a bonus to a third person in order to secure the allotment of the shares is not conclusive evidence that he should be regarded as a transferee from that person and as such deprived of the defence of fraud.³

§ 212. **Action for Damages for Deceit by defrauded Subscriber.** — A person who is induced by fraud to subscribe for shares in a corporation cannot retain the shares and at the same time maintain an action of tort for deceit against the company. If for any reason his right to rescind is lost, he cannot sue the company in tort for deceit.⁴ His rights in that respect differ from those of a person who has been induced by fraud to purchase land, chattels, or ordinary choses in action. It would seem, however, that the defrauded subscriber may maintain an action of tort for deceit against the individual officers or agents who were guilty of fraud, although he be disabled or averse from giving up the shares.⁵

§ 213-§ 219. *What sufficient Fraud or Misrepresentation to justify Rescission.*

§ 213. **In general.** — In respect to the question what will amount to such fraud or misrepresentation as will afford a defence to an agreement to take shares, such a contract does not

¹ *Tyler v. Savage*, 143 U. S. 79; But see *Dorsey Machine Co. v. Vreeland v. New Jersey Stone Co.*, *McCaffrey*, 139 Ind. 545; 38 N. E. 29 N. J. Eq. 188; *Mack v. Latta*, 208; 47 Am. St. Rep. 290. 178 N. Y. 525; 71 N. E. 97; 67 L. R. A. 126.

² *Berryville Land, etc. Co. v. Lewis*, 19 S. E. Rep. 781 (Va.). 454; 37 S. E. 478, *Getchell v. Dusenbury* (Mich.), 108 N. W. 723;

³ *McClanahan v. Ivanhoe Land, etc. Co.*, 96 Va. 124; 30 S. E. 450. N. W. 949; *Hall v. Old Talargoch*

⁴ *Houldsworth v. City of Glasgow Bank*, 5 A. C. 317; *Wilson v. Hundley*, 96 Va. 96; 30 S. E. 492; 70 Am. St. Rep. 837. Cf. *Wallace v. Hood*, 89 Fed. 11, 22-23. *Lead Mining Co.*, 3 Ch. D. 749 (when the court refused to stay proceedings in an action by a subscriber against the company and the directors jointly). See also,

differ from other contracts.¹ It has been held that if the misrepresentation be material and be relied upon by the subscriber, he may rescind the contract even though he would have subscribed had no misrepresentation been made.² Certainly, the defrauded subscriber may rescind without showing that the shares were worth less than he paid for them.³ Some authorities maintain that an agreement to take shares in a corporation is within the class of contracts *uberrimae fidei* which are voidable for mere non-disclosure without proof of actual misrepresentation;⁴ but the prevalent and better opinion is that this is not so, and that such agreements are voidable for non-disclosure only when the *suppressio veri* makes that which is stated false or misleading.⁵

§ 214. **Misrepresentation as to Corporation Affairs.** — Certain cases of representations relating to corporation affairs involve questions which do not usually arise except with respect to contracts to take shares. A statement in a prospectus that A is a director will justify rescission of a contract of subscription to shares, although the representation may have been true at the time, if A retires before allotment.⁶ A statement in a prospectus that A was expected to become a director is deemed untrue where A had expressed an intention of becoming a director but had not authorized the publication of his name.⁷ A representation that undrawn profits to a large amount had

Grover v. Cavanaugh (Ind.), 82 N. E. 104 (holding that oral misrepresentations by officers as to the financial condition of the company will sustain an action by the defrauded subscriber notwithstanding Lord Tenterden's Act).

¹ *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99.

Cf. *Oakes v. Turquand*, L. R. 2 H. L. 325; *Jackson v. Turquand*, L. R. 4 H. L. 305; *London & Staffordshire Fire Ins. Co.*, 24 Ch. D. 149; *Smith v. Reese River Co.*, 2 Eq. 264 (in substance affirmed in *Reese River Co. v. Smith*, L. R. 4 H. L. 64); *Wainwright's Case*, 63 L. T. 429; *Byers Bros. v. Maxwell* (Tex.), 73 S. W. 437.

² *Ex parte Carling*, 56 L. J. Ch. 321.

But see *Pulsford v. Richards*, 17 Beav. 87.

³ *Stern v. Kirkby Lumber Co.*, 134 Fed. 509; *Spreckels v. Gorrill* (Cal.), 92 Pac. 1011.

⁴ Anson on Contracts, 8th ed., 160. Cf. *Components Tube Co. v. Naylor* (1900), 2 Ir. 1; *New Brunswick, etc. Co. v. Muggeridge*, 1 Dr. & Sm. 363.

⁵ Cf. *Aaron's Reef's v. Twiss*, (1896), A. C. 273; *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99; *Pulsford v. Richards*, 17 Beav. 87.

⁶ *Anderson's Case*, 17 Ch. D. 373; *Scottish Petroleum Co.*, 23 Ch. D. 413.

⁷ *Karberg's Case* (1892), 3 Ch. 1. Cf. *Ex parte Wainwright*, 59 L. J. Ch. 281.

been appropriated as a "reserve fund" is not the less true because the profits in question were not invested as a separate fund but were made part of the working capital.¹ A representation that no shares had been sold for less than par is very material.² The same is true of a representation that the company is legally incorporated, whereas in fact some of the proceedings necessary to secure limited liability have been omitted.³ On the other hand, a representation that neighbors and friends of the subscriber have also agreed to become shareholders has been thought immaterial.⁴ This decision, however, must be supported, if at all, upon the ground that the representation was too indefinite to be relied upon; for a representation that a named person has subscribed is certainly material and will justify rescission if the individual in question was not a *bona fide* subscriber.⁵ A representation that the company is free from debt has been held to mean that the land which constitutes its only property is unincumbered.⁶

§ 215. **Misrepresentation as to Matters of Law.** — By the principle of law usually accepted in England and America, contracts are not voidable for misrepresentation, even though fraudulent, as to matters of law; and hence agreements to take shares cannot be avoided because they may have been induced by fraudulent misstatements as to the powers of the company under its act of incorporation or as to the purport or effect of the general enabling act, if the company be organized under a general law.⁷ Hence, also, a wilfully false statement that the shares are "non-assessable" will not be ground for repudiation of liability.⁸

§ 216. **Misrepresentation as to Contents of Incorporation Paper.** — Misrepresentation as to the contents of the incorpora-

¹ *Kennedy v. Acadia Pulp, etc.* 503; *Alabama Foundry, etc. Works Co.*, 38 Nova Scotia 291. *v. Dallas*, 29 So. 459; 127 Ala. 513.

² *Hubbard v. International Mercantile Agency* (N. J.), 59 Atl. 24. ³ *Tinker v. Kier*, 195 Mo. 183; 94 S. W. 501.

Cf. *Wenstrom Consol., etc. Co. v. Purnell*, 75 Md. 113, 122; 23 Atl. 134. ⁷ 1 Morawetz on Priv. Corps., 2d ed., § 95.

⁴ *Maine v. Midland Investment Co.* (Iowa), 109 N. W. 801. Cf. *Clem v. Newcastle, etc. R. R. Co.*, 9 Ind. 488; 68 Am. Dec. 653.

⁵ *Haskell v. Worthington*, 94 Mo. 560; 7 S. W. 481. ⁸ *Upton v. Tribilcock*, 91 U. S. 45; *Parker v. Thomas*, 19 Ind. 213; 81 Am. Dec. 385; *Ellison v. Mobile, etc. R. R. Co.*, 36 Miss. 572.

⁶ Cf. *Coles v. Kennedy*, 81 Iowa 360; 46 N. W. 1088; 25 Am. St. Rep.

tion paper may entitle a person who has agreed to take shares on the faith thereof to repudiate the agreement.¹ In England the opinion has been advanced that such misrepresentation, after the paper has been recorded and therefore after the applicants for shares have an opportunity of examining it for themselves, will not justify rescission,² and the same principle has been approved in America;³ but nevertheless this opinion seems to be without support in principle especially where the misrepresentation is fraudulent.⁴ The doctrine of constructive notice should not be perverted into a cover for fraud.⁵ Such misrepresentations usually occur in cases of departure from the original scheme laid down for the company by its promoters in a prospectus published before incorporation. The mere fact of such departure affords no defence to a person who has subscribed for shares after the incorporation paper, embodying the altered scheme, has been executed and recorded, unless the original prospectus or other statements setting forth the original scheme be circulated after the change was made, and be brought to the knowledge of and relied upon by the applicant for shares. The case of an application for shares made prior to incorporation, as affected by subsequent departures from the original scheme, is considered below.⁶

§ 217. **Misrepresentation unauthorized by Corporation.** — In order that a contract of subscription to shares may be rescinded for misrepresentation, it is in general necessary that the misrepresentation be proved to have been made by an agent of the corporation duly authorized to make representations for the purpose of inducing persons to subscribe to the shares.⁷ Rescission may, however, be had on account of misrepresentation, which was made by promoters prior to the company's incorporation. If the company accepts an application for shares,

¹ *Central Ry. Co. v. Kisch*, L. R. 2 H. L. 99.

² Cf. *Ross v. Estate Investment Co.*, 3 Eq. 122; *Oakes v. Turquand*, L. R. 2 H. L. 325.

³ *Oil City Land, etc. Co. v. Porter*, 99 Ky. 254; 35 S. W. 643.

⁴ Cf. *Langham v. East Rose Wheal, etc. Co.*, 37 L. J. Ch. 253 (where a misleading prospectus was held to justify rescission of an

agreement to take shares, although the prospectus referred applicants for shares to a recorded document inspection of which would have disclosed the untruth of the misrepresentations).

⁵ See *supra*, § 162.

⁶ *Infra*, § 258.

⁷ *Newlands v. National Employers, etc. Ass'n*, 54 L. J. Q. B. 428.

which was made, and is known by the company to have been made, in reliance upon statements of promoters made before incorporation, the corporation thereby adopts those representations, so that they have the same effect in rendering the agreement voidable as if they had been made by agents of the company after its formation.¹

§ 218. **Misrepresentation as to Nature of Transaction.** — Where misrepresentation goes to the nature of the transaction — for example, where a person signs a subscription to shares under the belief, induced by fraud, that he is merely depositing money in a bank — he never becomes a shareholder and may apparently repudiate the shares in spite of delay or of the supervision of winding-up proceedings.²

§ 219. **Misrepresentation as to Identity of Company.** — In a case of misrepresentation or mistake as to the identity of the company whose shares are applied for, there is no meeting of minds and therefore no contract at all. For example, it was held in England that where a person received an allotment of shares in a company recently incorporated, the application having been made under the erroneous belief, fostered by the directors, that the company was a different and long-established corporation, there was no meeting of minds and therefore no contract at all — not even a voidable one; so that the allottee was not liable in respect of the shares although the company went into liquidation before he repudiated ownership.³

§ 220. **How Contract of Subscription may be performed.** — A contract to subscribe for or to take shares in a corporation is satisfied either by personally accepting the shares or by finding some one else who will do so.⁴ Performance by the corporation means the issue of valid shares. It does not necessarily include the issue of a share-certificate.⁵ If the contract calls for paid-up

¹ *Karberg's Case* (1892), 3 Ch. 1.

² *National Ins., etc. Ass'n*, 4 De G.

Cf. *Lynde v. Anglo-Italian, etc.* F. & J. 78.

Spinning Co. (1896), 1 Ch. 178;

³ *Baillie's Case* (1898), 1 Ch. 110.

Stewart v. Rutherford, 74 Ga. 435;

Cf. *Stewart v. Austin*, 3 Eq. 299.

and *infra*, § 257 and § 337. But see

⁴ *London & Colonial Finance*

Gourlie v. Chandler, 41 Nova Scotia

Corp., 77 L. T. 146.

341.

⁵ *Infra*, § 233 and *supra*, § 171.

shares, the company can perform its part only by issuing shares which are in fact and law fully paid up.¹

§ 221-§ 227. CONDITIONAL AGREEMENTS TO TAKE SHARES.

§ 221-§ 223. *Conditions Precedent.*

§ 221. **In general.** — Conditional subscriptions to shares have occasioned considerable diversity of judicial opinion. We shall first consider subscriptions upon a condition *precedent* — that is to say, agreements to become a shareholder in a corporation if a certain contingency occurs. The objection to such agreements is that, if they are binding, they tie up the company and prevent it from allotting the shares to other applicants who might be willing to accept the same unconditionally, and yet do not enable the corporation to call in the portion of the capital represented by the shares so subscribed for. In other words, if such agreements are binding, the company incurs at once all the disadvantages of an absolute allotment, but receives none of the benefits until the condition is performed. Accordingly, it is usually laid down in America that either party may withdraw from such conditional agreements at any time before the condition is performed.² According to these authorities, such conditional subscriptions are void as contracts but operate as offers which may be accepted by performing the condition.³ Some cases hold that conditional subscriptions are not contrary to law, and that therefore the subscriber cannot withdraw even before the condition is performed.⁴ Of course, unless the con-

¹ *Ecuadorian Ass'n v. Ecuador Co.* (N. J.), 65 Atl. 1051 (headnote inadequate). See *infra*, § 233, § 779, and § 789.

² See 1 Morawetz on Priv. Corps., 2d ed., § 78-§ 81.

Cf. *Taggart v. Western Md. R. R. Co.*, 24 Md. 563; 89 Am. Dec. 760 (semble); *Baltimore, etc. R. R. Co. v. Pumphrey*, 74 Md. 86; 21 Atl. 559.

³ *Webb v. Baltimore, etc. R. R. Co.*, 77 Md. 92; 26 Atl. 113; 39 Am. St. Rep. 396; *Ashtabula, etc. R. Co. v. Smith*, 15 Oh. St. 328, 335; *Taggart v. Western Md. R. R. Co.*, 24 Md. 563; 89 Am. Dec. 760.

If the performance of the condition lies peculiarly within the company's knowledge, the subscriber will not be bound unless the company give him notice of performance. *Chase v. Sycamore, etc. R. R. Co.*, 38 Ill. 215.

⁴ *New Albany, etc. R. R. Co. v. McCormick*, 10 Ind. 499; 71 Am. Dec. 337; *Cravens v. Eagle Cotton Mills Co.*, 120 Ind. 6; 21 N. E. 981; 16 Am. St. Rep. 298; *Philadelphia, etc. R. R. Co. v. Hickman*, 28 Pa. St. 318; *Van Allen v. Illinois Central R. Co.*, 7 Bosw. (N. Y.) 515, 523-524 (holding that the company is bound).

dition is performed, the subscriber cannot be held even though his name may have been entered by the company on the register of members,¹ unless indeed the condition be waived by acting as shareholder or otherwise.² Such waiver will not be binding if the subscriber believed that the condition had been performed.³ The fact of filing an application for removal of the applicant's name from the register of shareholders on the ground that his subscription had been obtained by fraud will not amount to waiver of non-performance of a condition precedent.⁴ If subscriptions upon conditions precedent are legally no subscriptions at all until the condition be performed or waived, they cannot be counted in calculating whether the capital has been completely subscribed.⁵

§ 222. **Underwriting Agreements.** — Inasmuch as the only objection to subscriptions upon conditions precedent is that they tie up the company and prevent the allotment of the shares to persons who might be willing to subscribe unconditionally,

Perhaps, this is the law in England. See *Hirsch v. Burns*, 77 L. T. 377; *Consolidated Copper Co. v. Peddie*, 5 Rettie 393; *Shaw's Case*, 34 L. T. 715.

Cf. *Racine County Bank v. Ayers*, 12 Wisc. 512 (where the court said that the conditional subscription was valid but where the actual decision was that upon performance of the condition, the subscriber not having previously withdrawn became bound).

¹ *Rogers' Case*, 3 Ch. 633; *Simpson's Case*, 4 Ch. 184; *Sunken Vessels Recovery Co.*, 3 De G. & J. 85.

Cf. *Wood's Case*, 15 Eq. 236; *Elder v. New Zealand Co.*, 30 L. T. 285; *Audenried v. East Coast Milling Co.*, 59 Atl. 577 (N. J.).

But see *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Boyd v. Peach Bottom Ry. Co.*, 90 Pa. St. 169. These Pennsylvania cases may perhaps be supported on the ground that the condition was really a condition subsequent.

² Cf. *supra*, § 194. 1 Morawetz on Priv. Corps., 2d ed., § 91—§ 93, where the nature of the so-called

"waiver" as the making of a new contract is forcibly pointed out.

See also *Lane v. Brainard*, 30 Conn. 565, 579 (waiver by acting as director); *Wheatcroft's Case*, 42 L. J. Ch. 853; *Imperial Land Corporation*, 16 W. R. 1191 (acting as director held not proof of waiver of condition); *Slipher v. Earhart*, 83 Ind. 173 (waiver by executing unconditional note for amount of shares); *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Oh. St. 225 (waiver by executing unconditional note); *Dayton, etc. R. R. Co. v. Hatch*, 1 Disney (Oh.) 84 (payment of calls, voting as shareholder, etc.); *Wyman v. Bowman*, 127 Fed. 257, 265—266; 62 C. C. A. 189.

But see *Ridgefield, etc. R. R. Co. v. Reynolds*, 46 Conn. 375 (where the condition was held not to be waived by acting as shareholder).

³ *Hawkins v. Citizens Real Estate, etc. Co.* (Oreg.), 64 Pac. 320.

⁴ *Tomlin's Case*, 14 Times L. R. 53.

⁵ *Central Turnpike Corp. v. Valentine*, 10 Pick. (Mass.) 142.

it follows that if the company is left free to allot the shares to any one else, the conditional subscription is valid, and binds the conditional subscriber. For this reason, underwriting agreements, or contracts to take certain shares if they are not subscribed by the public, are valid and binding upon the underwriter.¹

§ 223. **Bonds or Scrip convertible into Shares.** — The issue of bonds or scrip convertible into shares at the option of the holder is really a subscription to the shares upon a condition precedent and is liable to the same objections. If the company is bound by the conditional agreement, it cannot allot the shares to any one else until the time for performance of the condition be passed. If this reasoning be sound, the issue of such convertible bonds would not be lawful without affirmative statutory authority; or at any rate the corporation would not be liable for allotting the shares to third persons, or for repudiating the option in any other manner, at any time before the exercise of the option. In at least one case, however, this argument did not prevail, but on the contrary the court held that the corporation could not escape from the obligation to exchange the bonds for shares.² At any rate, the issue of bonds convertible into shares at the option of the company would not be open to any such objection; for the company would still be at liberty to allot the shares to other persons and would therefore run no risk of losing unconditional subscribers to its capital.

§ 224–§ 226. *Conditions Subsequent.*

§ 224. **In general.** — A subscription to shares coupled with a condition subsequent — that is to say, an agreement to become a shareholder subject to the proviso that in a certain contingency the subscriber shall cease to be a shareholder — is so far good that if shares are actually issued to the subscriber, the issue is valid; the condition should be rejected as repugnant,

¹ Cf. *Re Hooley* (1899), 2 Q. B. 579. See *infra*, § 439.

Cf. *Denney v. Cleveland, etc. R. R. Co.*, 28 Oh. St. 108 (where the

² *Van Allen v. Illinois Central R. R. Co.*, 7 Bosw. (N. Y.) 515. question was left open).

ultra vires, and void.¹ The issue of shares as collateral security for a debt of the company seems to be permitted, and if so must be deemed an exception to the principle just stated.² Moreover, a condition that in a certain event some other person shall be substituted as shareholder does no more than provide for a transfer, and is valid.³ A condition that, upon failure to pay calls or the like, the subscriber's membership shall cease is substantially equivalent to the reservation of a power of forfeiture (which the law would imply without express words) and would therefore seem to be unobjectionable.⁴ What is intended as a condition subsequent, while ineffective as a condition, may operate as a promise on the part of the company to perform the intended condition so as to give the shareholder a right of action against the company for damages in case of breach.⁵

§ 225. **Redeemable Shares.** — Redeemable shares are really shares issued upon a condition subsequent. Nevertheless, it is generally held in America that, even without the affirmative statutory authority which sometimes exists, redeemable shares

¹ *Pittsburgh, etc. R. R. Co. v. Biggar*, 34 Pa. St. 455; *Southport, etc. Banking Co.*, 55 L. J. Ch. 497; *Melvin v. Lamar Ins. Co.*, 80 Ill. 446; 22 Am. Rep. 199; *Addison's Case*, 5 Ch. 294; *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Stunt v. Newark Weldless, etc. Co.*, 22 Oh. Circ. Ct. 120; *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Oh. St. 225, 247 (semble); *Australian Producers & Traders*, 31 Vict. L. R. 511 (a strong case).

Cf. *Black & Co.'s Case*, 8 Ch. 254, 258-260 (headnote inadequate); *Pellatt's Case*, 2 Ch. 527, 532-533; *Mare v. Anglo-Indian S. S. Co.*, 3 Times L. R. 142; *Fort Miller, etc. Co. v. Payne*, 17 Barb. (N. Y.) 567, 579; *Boyd v. Peach Bottom Ry. Co.*, 90 Pa. St. 169; *Bucksport, etc. R. R. Co. v. Buck*, 68 Me. 81, 84-85 (headnote inadequate).

But see *Vent v. Duluth Coffee, etc. Co.*, 64 Minn. 307; 67 N. W. 70; *Porter v. Plymouth Gold Mining Co.*, 29 Mont. 347; 74 Pac. 938; 101 Am. St. Rep. 569.

A fortiori, the rule stated in the text applies where the condition is kept secret. *Great Western Tel. Co. v. Haight*, 49 Ill. App. 633; *White Mountains R. R. Co. v. Eastman*, 34 N. H. 124; *Olmstead v. Vance, etc. Co.*, 196 Ill. 236; 63 N. E. 634.

² Cf. *Burgess v. Seligman*, 107 U. S. 20; 2 Sup. Ct. 10; *McLean-Bowman Co.*, 138 Fed. 181.

But see *Brewster v. Hartley*, 37 Cal. 15; 99 Am. Dec. 237 (where it was said that stock cannot be issued as collateral security for the company's own debt); *Addison's Case*, 5 Ch. 294.

³ *Burke v. Smith*, 16 Wall. 390.

But cf. *Swartwout v. Michigan Air Line R. R. Co.*, 24 Mich. 389.

⁴ Cf. *Weeks v. Silver Islet, etc. Mining Co.*, 23 Jones & S. (N. Y.) 1. But see *Mann v. Cooke*, 20 Conn. 178.

⁵ *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Oh. St. 225, 247 (semble); *Stunt v. Newark Weldless, etc. Co.*, 22 Oh. Circ. Ct. 120 (semble).

may be issued whether the option of redemption rests with the shareholder¹ or with the company.² Wherever corporations are held to have an implied power to purchase their own shares it is not surprising that this conclusion should be reached.

§ 226. **Shares convertible into Bonds.** — The issue of shares convertible into bonds or debentures is likewise really an issue subject to a condition subsequent. The issue of such convertible shares is sometimes expressly authorized by statute. Apart from statute, it is submitted that a provision for conversion into bonds should be held to be illegal; but undoubtedly many American courts — particularly those courts which concede the power of a corporation to purchase its own shares — would uphold such a provision even without the aid of any statute. Where conversion of shares into bonds is provided for, and no time is expressly limited for an exercise of the option by the shareholder, he must nevertheless exercise it within a reasonable time and cannot be allowed to call for bonds in exchange for his shares, after the lapse of years and after the company has become insolvent.³

§ 227. **Whether Agreement to be construed as Absolute or Conditional and whether Condition to be construed as Precedent or Subsequent.** — Considerable difficulties may be experienced in determining whether a subscription should be construed to be conditional,⁴ and if so whether the condition should be con-

¹ *Browne v. St. Paul Plow Works, Co. v. Camden* (Va), 56 S. E. 561; 62 Minn. 90; 64 N. W. 66; *Vent v. Lindsay v. Arlington Co-op. Ass'n*, 186 Mass. 371; 71 N. E. 797.

² But see *Olmstead v. Vance, etc. Co.*, 196 Ill. 236; 63 N. E. 634; *Long v. Guelph Lumber Co.*, 31 Up. Can. C. P. 129; *Boley v. Sonora Development Co. (Mo.)*, 103 S. W. 975.

³ *Hackett v. Northern Pac. Ry. Co.*, 36 N. Y. Misc. 583; 73 N. Y. Supp. 1087.

⁴ *Catlin v. Green*, 120 N. Y. 441; 24 N. E. 941.

Cf. *McIntyre v. E. Bement's Sons* (Mich.), 109 N. W. 45.

⁴ See *Lane v. Brainard*, 30 Conn. 565; *Shaw's Case*, 34 L. T.

strued to be precedent or subsequent. In doubtful cases, the courts incline to hold the subscription to be conditional, and the condition to be a condition precedent.¹ Thus, where a letter of allotment contained a provision that after payment of the allotment money no further call would be made until the report of a committee of directors appointed to investigate a mine which the company was formed to purchase, and that "if the board resolve not to purchase the mine, the money will be returned to the shareholders without deduction," the Scotch Court of Session held that the allotment was subject to a condition precedent.² So, where the subscriber's name was entered on the register of shareholders, but with a memorandum stating that the allotment was conditional, and where the share-certificates were deposited in escrow to await the performance of the condition, the court held that the condition was a condition precedent.³ So, where an application for shares is made as a part of a scheme for the amalgamation of two companies and upon the supposition that the amalgamation will be consummated, if for any reason the consolidation is not accomplished or is set aside, the application falls with it.⁴ Where the application for shares is made by the subscriber on the faith of a prospectus, a condition inserted in the prospectus may sometimes be read into the offer of the subscriber. Thus, where the prospectus states that no allotment

715 (where the condition was that the applicant should be appointed director); *Re Mogridge*, 57 L. J. Ch. 932 (condition that applicant should be appointed manager); *Rankin v. Hop, etc. Exchange Co.*, 20 L. T. 207; *Simpson v. Heaton's, etc. Co.*, 19 W. R. 614; *Morrow v. Iron & Steel Co.*, 87 Tenn. 262; 10 S. W. 495; 10 Am. St. Rep. 658; 3 L. R. A. 37; *Chamberlain v. Painesville, etc. R. R. Co.*, 15 Oh. St. 225; *Swartwout v. Michigan Air Line R. R. Co.*, 24 Mich. 389; *Sweeney v. Tenn., etc. R. R. Co.* (Tenn.), 100 S. W. 732 (subscription construed not to be conditional but merely subject to special terms).

¹ Cf. *Sunken Vessels Recovery Co.*, 3 De G. & J. 85; *Cook v. Chittenden*,

25 Fed. 544; *Bucksport, etc. R. R. Co. v. Brewer*, 67 Me. 295; *Parker v. Thomas*, 19 Ind. 213; 81 Am. Dec. 358.

But see *Paducah, etc. Railroad Co. v. Parks*, 86 Tenn. 554; 8 S. W. 842; *Cravens v. Eagle Cotton Mills Co.*, 120 Ind. 6; 21 N. E. 981; 16 Am. St. Rep. 298; *Australian Producers & Traders*, 31 Vict. L. R. 511; *North Missouri R. R. Co. v. Miller*, 31 Mo. 19.

² *Consolidated Copper Co. v. Peddie*, 5 Rettie 393.

³ *Spitzel v. Chinese Corp.*, 15 Times L. R. 281.

But see *Southport, etc. Banking Co.*, 55 L. J. Ch. 497.

⁴ *Bank of Hindustan v. Alison*, L. R. 6 C. P. 222; *Stace and Worth's Case*, 4 Ch. 682.

But see *Campbell's Case*, 9 Ch. 1.

will be made until a certain number of shares have been subscribed, an application for shares based thereon is subject to that condition precedent and cannot be accepted until the stipulated number of shares have been subscribed.¹

§ 228. **Subscriptions on Special Terms.** — Subscriptions on special terms differ from conditional subscriptions in that, while the rights or liabilities of the shareholder are, by agreement, varied from those which the law annexes to the status in the absence of any special arrangement, still there is no proviso that, in case of lack of compliance with the agreement for special rights or liabilities, the subscriber shall cease to be a shareholder.² It is perfectly competent for the company to make special terms with a shareholder as to his rights and liabilities, provided only such special terms do not conflict with some statutory provision or with the policy of the incorporation laws, or infringe in some way the rights of dissenting shareholders. Usually subscriptions on special terms confer special rights in respect to dividends, in which case they belong to the topic of preferred shares,³ or else they attempt to regulate the time or manner of payment for the shares, in which case they are part of the subject of payment for shares — a topic considered below.⁴

§ 229. **Application of Parol Evidence Rule.** — In dealing with questions as to subscriptions alleged to be conditional or subject to special terms, the parol evidence rule must constantly be borne in mind. Written subscriptions to shares like other contracts in writing cannot be varied by proof of special parol terms or conditions.⁵

§ 230. **Subscriptions in Excess of Authorized Capital.** — The subjects of excessive subscriptions for shares and of over-

¹ *Finance and Issue v. Canadian Thornsburgh v. Newcastle, etc. R. R. Produce Corp.* (1905), 1 Ch. 37, 45. *Co.*, 14 Ind. 499; *Thigpen v. Missi-*

² *Sweeney v. Tenn., etc. R. R. Co.* (Tenn.), 100 S. W. 732, 736. *Mississippi Central R. R. Co.*, 32 Miss. 347; *Smith v. Tallahassee, etc. Plank Road Co.*, 30 Ala. 650; *Wight v. Shelby R. R. Co.*, 16 B. Monr. (Ky.) 4; 63 Am. Dec. 522.

³ *Infra*, § 525 et seq.

⁴ *Infra*, § 774 et seq.

⁵ *New Albany, etc. R. R. Co. v. Fields*, 10 Ind. 187; *Vicksburg, etc. R. R. v. McKean*, 12 La. Ann. 638; 80 Pa. St. 31. See also *supra*, § 185.

issued shares are involved in no little obscurity. Of course, where the capital of a corporation is limited, the company has no right to issue shares in excess of the prescribed limit; but the mere fact that the company has agreed to issue more shares than it can lawfully issue does not release subscribers to whom the company is able and willing to issue valid shares.¹ If after issuing shares to the full amount of its authorized capital, it should undertake to issue additional shares, the contract so to do would be *ultra vires* and unenforceable either by or against the company. Even if the contract should, so far as possible, be executed by the issue of share-certificates and otherwise, the allottees would acquire (unless under very exceptional circumstances) no rights of membership.² If the overissued shares should be transferred to *bona fide* purchasers, the company might be estopped from questioning the validity of the shares in their hands;³ so that they would have a cause of action against the company for damages; but not even *bona fide* purchasers would be actual shareholders, so as to be entitled to vote, for example, or to participate in dividends.⁴ Of course, no *ultra vires* increase of capital can affect the vested rights and obligations of persons who have already become shareholders.⁵

In a case of mere executory contracts to issue shares in excess of the authorized capital, it would seem that holders of the first contracts in point of time would be entitled to a preference in the distribution of the authorized shares. Nevertheless, those who without notice of any outstanding equities first attain the position of actual shareholders, and thus become intrenched behind the legal title, will prevail over persons who subscribed before them but to whom no shares had been actually issued before the authorized capital was exhausted. The subscribers to whom the company can issue no shares by reason of the exhaustion of the entire authorized capital have a good claim for damages against the company.⁶

¹ *Oler v. Baltimore, etc. R. R. Co.*, 41 Md. 583; *Shick v. Citizens' Enterprise Co.*, 15 Ind. App. 329; 57 Am. St. Rep. 230.

But see *Bristol Creamery Co. v. Tilton*, 70 N. H. 239; 47 Atl. Rep. 591.

² *Infra*, § 579, § 580.

³ *Infra*, § 909, § 580.

⁴ *Ibid.*

⁵ *Cartwright v. Dickinson*, 88 Tenn. 476; 12 S. W. 1030; 17 Am. St. Rep. 910; 7 L. R. A. 706. Cf. *infra*, § 581.

⁶ *Birmingham Nat. Bank v. Roden*, 97 Ala. 404; 11 So. 883.

Still more difficult questions arise where the valid shares cannot be traced and distinguished from the overissued shares. Such confusion cannot so readily occur in England, where each share is distinguished by a denoting number; and indeed the English system of numbering shares is a valuable check upon overissue. In former days in America, particularly in cases of incorporation under special acts, commissioners used to be appointed with power to apportion the shares in case of over-subscription.¹

§ 231. **Rescission or Modification of Agreement to take Shares.** — So long as an agreement to take shares in a corporation remains executory — that is to say, until the subscriber has become an actual shareholder — it may, like any other contract, be rescinded or modified by mutual consent.² So, if the company refuses to issue the shares as agreed, the subscriber, upon giving due notice of his election to rescind the contract, may recover back any sum paid upon his subscription upon the ground of failure of consideration.³ Of course, a gratuitous release of one who has subscribed to the company's capital would generally be *ultra vires*, and might be void as in fraud of creditors; but the company has the same control over executory contracts to take shares in its capital that it has over its other assets or choses in action. In America, where no formality such as entry on a register of members is generally necessary in order to make a person an actual shareholder, difficulty may be experienced in the application of the rule; but the rule itself is submitted to be as sound in the United States as in Great Britain. After the contract of subscription has been executed and the subscriber has become an actual shareholder, rescission by mere agreement is in general, according to the better view, no longer possible, except as a

¹ See 2 Clark & Marshall on Priv. Corps., § 514. Morawetz on Priv. Corps., 2d ed., § 110.

² *Florence Land Co.*, 29 Ch. D. 421; *Sahlgreen & Carrall's Case*, 3 Ch. 323, 328, 329 (headnote inadequate); *Barnett's Case*, 18 Eq. 507; *Whiteley's Case*, 1 Megone 154; *Cook v. Chittenden*, 25 Fed. 544 (headnote inadequate); *Chetlain v. Republic Life Ins. Co.*, 86 Ill. 220, 224-225 (headnote inadequate); 1 N. H. 200.

Cf. *Kipling v. Todd*, 3 C. P. D. 350.

But see *Adams' Case*, 13 Eq. 474; *Davidson's Case*, 4 K. & J. 688.

As to the rule in respect to subscribers of the incorporation paper, see *infra*, § 242.

³ *Swazey v. Choate Mfg. Co.*, 48

compromise of a *bona fide* dispute as to whether the shareholder is bound.¹

§ 232-§ 236. *Remedies for Breach of Executory Contracts of Subscription.*

§ 232. **Actions at Law — By the Subscriber.** — An agreement to take shares in a corporation, like any other contract, may be sued upon at law by either party in case of a breach by the other. For instance, if a corporation which has accepted an application for shares refuses to issue them as agreed, the applicant may sue the company in assumpsit, and recover the difference between the market value of the shares and the amount — usually, of course, their par value — which he would have had to pay for them.² If he has paid for the shares in full, the measure of damages would be the market value of the shares;³ but an action for money had and received to recover back the money which he has paid will not lie.⁴

§ 233. **By the Corporation.** — Conversely, if the subscriber refuses to accept the allotted shares, the company may have an action of assumpsit against him. Such an action, however, must be distinguished from an action to recover calls.⁵ The breach laid would be, not the failure to pay calls, but the refusal to accept the shares. An action for calls is an action to recover a liquidated sum of money which the defendant is under a duty or obligation to pay; an action for refusal to perform an agreement to take shares in the complaining corporation is an action for damages, in which the amount recoverable would rarely be the same as in an action for calls. The measure of damages would be the difference between the amount which the defendant as shareholder would have been liable to pay on call or other-

¹ See *infra*, § 635 et seq.

² Cf. *Hirsch v. Burns*, 77 L. T. 377; *Rogers v. Gladiator, etc. Co.* (S. Dak.), 113 N. W. 86 (holding that the action cannot be maintained where the contract called for issue of shares in violation of a constitutional provision requiring payment in money, labor, or property). That the company voluntarily goes

into liquidation is not a breach of such a contract. *Hirsch v. Burns*, 77 L. T. 377.

³ *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424.

⁴ *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424.

⁵ Cf. *Charlotte, etc. R. R. Co. v. Blakeley*, 3 Strob. (S. Car.) 245 (headnote inadequate).

wise — generally, of course, the par value of the shares — and the actual market value of the shares when paid-up.¹ In any such action it is incumbent on the company to show that it was ready and willing to carry out its part of the contract by issuing the shares,² and, if the contract calls for paid-up shares, that the shares if issued would be in fact and law paid-up.³ But since delivery of share-certificates is not necessary to constitute an issue of shares, there would be no necessity of proving a tender of certificates.⁴ If the company should by gross mismanagement or otherwise greatly depreciate the value of its shares after the making of a contract of subscription to shares and before the actual issue of shares thereunder, it would seem that the company, having disabled itself from carrying out the contract according to the expectation of the parties, would not be entitled to enforce the contract against the subscriber.⁵ In this additional respect, an action upon an executory agreement to take shares differs from an action against a person who has actually become a shareholder to recover the amount of his subscription, to which latter action fraudulent or *ultra vires* acts on the part of the corporation constitute no defence.⁶

§ 234. **Bills for Specific Performance.** — Some diversity of opinion has existed upon the question whether a court of equity should enforce specific performance of a contract of subscription to shares in the capital of a corporation. In one or two comparatively early English cases, the Master of the Rolls refused

¹ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

² *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

³ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

⁴ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

⁵ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

⁶ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

Land Co. v. Hayward, 95 Wisc. 109; 69 N. W. 567.

² *Ecuadorian Ass'n v. Ecuador Co.* (N. J.), 65 Atl. 1051 (headnote inadequate). See *infra*, § 778, § 789.

³ *Webb v. Baltimore, etc. R. R. Co.*, 77 Md. 92; 26 Atl. 113; 39 Am. St. Rep. 396; *Smith v. Gower*, 63 Ky. 17; *Slipher v. Earhart*, 83 Ind. 173; *Fulgam v. Macon, etc. R. Co.*, 44 Ga. 597; *Marson v. Deither*, 49 Minn. 423; 52 N. W. 38. See *supra*, § 171.

⁴ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

⁵ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

⁶ *Thrasher v. Pike Co. R. R. Co.*, 25 Ill. 393; *Mt. Sterling Carload Co. v. Little*, 14 Bush (Ky.) 429 (overruled in part by *Bullock v. Falmouth, etc. Co.*, 85 Ky. 184; 3 S. W. 129); *Rhey v. Ebensburg, etc. Co.*, 27 Pa. St. 261. See 1 Morawetz on Priv. Corps., 2d ed., § 46, p. 45, and § 50, p. 50.

to decree specific performance of the agreement against the subscriber.¹ But the tendency in more recent times has been the other way.² Specific performance cannot be had where the subscriber has become bankrupt, and the assignee in bankruptcy repudiates the contract of subscription.³ In one case where the directors of a corporation, believing themselves to be the only shareholders, sold the property of the company and divided the proceeds among themselves, the court held that a person to whom the company had agreed to issue shares but to whom no shares had been issued, should be regarded in equity as owner of the promised shares, and as such entitled to maintain a bill for an accounting against the directors.⁴

§ 235. **Statute of Limitations.** — A subscription to shares in the capital of a corporation being an ordinary contract governed by the same rules as other contracts in respect to actions or suits based thereon, it follows that the right to enforce such a contract may be barred by limitations.⁵ Upon an action against a shareholder for non-payment of calls, the statute of limitations does not begin to run until the call is made and notice thereof given.⁶ But where a person who has merely promised to become a shareholder repudiates the agreement and refuses to accept the allotted shares, he thereby commits a breach of contract and a court might well hold that the statute of limitations then commences to run.⁷

¹ *Bluck v. Mallalue*, 27 Beav. 398; *Sheffield Gas, etc. Co. v. Harrison*, 17 Beav. 294.

² *Odessa Tramways v. Mendel*, 8 Ch. D. 235.

Cf. *Arnot's Case*, 36 Ch. D. 702; *Florence Land Co.*, 29 Ch. D. 421; *Selover v. Isle Harbor Land Co.*, 91 Minn. 451; 98 N. W. 344; *Selover v. Isle Harbor Land Co.* (Minn.), 111 N. W. 155; *Edgerton v. Electric Imp. Co.*, 50 N. J. Eq. 354; 24 Atl. 540 (where specific performance prayed by the subscriber was refused on the ground that the contract was tainted with illegality); *Baumhoff v. St. Louis, etc. R. R. Co.* (Mo.), 104 S. W. 5 (specific performance decreed against the company in favor of a contractor who

had performed services to be paid for with shares, the shares having no market value); *Garrett v. Kansas City Coal Mining Co.*, 113 Mo. 330; 20 S. W. 965; 35 Am. St. Rep. 713 (specific performance against company refused where contract provided for issue of shares as fully paid in exchange for property at an inflated valuation). See also *infra*, § 975.

³ *Re Hooley* (1899), 2 Q. B. 579.

⁴ *Pendery v. Carleton*, 87 Fed. 41; 30 C. C. A. 510.

⁵ *Florence Land Co.*, 29 Ch. D. 421, 442.

⁶ See *infra*, § 761.

⁷ But see *Haggert Bros. Mfg. Co.*, 19 Ont. App. 582 (where defendant was a charter member).

§ 236. **Laches.** — Not merely may the right to enforce a contract of subscription to shares of capital stock be barred at law by limitations, but it may in equity be lost by laches.¹

§ 237. **Scrip and Scripholders.** — In cases where for any reason it is deemed desirable to postpone the actual issue of shares, the expedient is sometimes adopted of issuing "scrip," or certificates stating that the holder thereof will be entitled to a certain number of shares when issued by the company. A holder of such scrip is not a shareholder, but merely a person who is entitled under certain circumstances to become a shareholder.² Hence, a scripholder is not subject to the liabilities of a shareholder.³ The scrip may be of various sorts. For instance, the terms may be such that upon the occurrence of certain contingencies, the company has the right to insist that the holder shall take the shares.⁴ Or, the scripholder may have a mere option of becoming a shareholder; and in that case the company has no right without his consent to enter his name on the share-register, so as to subject him against his will to the obligations of a shareholder.⁵ The only right of the company in such a case is to give notice that the scripholder might be registered as a shareholder, and then if the option be not exercised within a reasonable time to allot the shares to other persons.⁶ One of the strongest reasons for issuing scrip is to enable the holder to transfer his rights more readily than could otherwise be done. Accordingly, where the scrip is by its terms transferable by delivery so as to be enforce-

¹ *Florence Land Co.*, 29 Ch. D. 421; *Whiteley's Case*, 1 Megone 154.

Cf. *Carter, etc. Co. v. Hazzard*, 65 Minn. 432; 68 N. W. 74.

² *Eustace v. Dublin Trunk Ry. Co.*, 6 Eq. 182.

³ *Ormerod's Case*, 5 Eq. 110. He may, however, under some circumstances be liable as a person who has agreed to become a shareholder. *Barton's Case*, 4 De G. & J. 46.

⁴ *Midland, etc. Ry. Co. v. Gordon*, 16 M. & W. 804.

Cf. *Van Allen v. Illinois Central R. R. Co.*, 7 Bosw. (N. Y.) 515.

Quære, whether scrip certificates are not sometimes open to the objection that they constitute conditional agreements to take shares.

See supra, § 221-§ 223.

Cf. *Van Allen v. Illinois Central R. R. Co.*, 7 Bosw. (N. Y.) 515, 523-524.

⁵ *McIlwraith v. Dublin Trunk Ry. Co.*, 7 Ch. 134.

⁶ *McIlwraith v. Dublin Trunk Ry. Co.*, 7 Ch. 134.

Cf. *Ex parte Collum*, 9 Eq. 236; *Barton's Case*, 4 De G. & J. 46.

able by the bearer, a mercantile custom that it shall be deemed negotiable will be respected by the courts, so that in a case of fraudulent conversion the true owner cannot maintain an action of trover against a *bona fide* purchaser.¹ Even where the scrip is declared to be "negotiable only by transfer on the books of the company, and with the assent of this company first obtained thereto," it has been held that the complete equitable title may pass without the company's assent by an unrecorded transfer;² but this doctrine as thus broadly stated may perhaps be questioned, the company's assent being made a condition precedent to the passing of either legal or equitable title as against the company itself. Ordinarily, any obligations which the scrip-holder may undergo are escaped by a *bona fide* transfer of his scrip.³ Sometimes so-called scrip-certificates are issued to actual shareholders; but these instruments are in legal effect mere share-certificates, and accordingly a transfer of such "scrip" will not relieve the holder of the liabilities of a shareholder unless the transfer has been made in the mode prescribed by law for making an assignment of shares.⁴

§ 238-§ 248. AGREEMENTS MADE BY SIGNING INCORPORATION PAPER.

§ 238. **Peculiarity of such Agreements.**—The second class of agreements to take shares mentioned above⁵ consists of agreements entered into by subscribing the incorporation paper. This class of agreements to take shares is peculiar in several respects. All these peculiarities spring from the circumstance that subscriptions of the incorporation paper are part of the machinery provided by law for the organization of the company. Such subscriptions must, therefore, by force of the statute have such operation as will enable them to discharge that function. Even where the statute does not require or con-

¹ *Rumball v. Metropolitan Bank, Gordon*, 16 M. & W. 804, holding 2 Q. B. D. 194.

² *Hubbard v. Manhattan Trust Co.*, 87 Fed. 51, 57-58; 30 C. C. A. 520. that the liabilities of the original scrip-holder continue until the transferee of the scrip has been actually registered as shareholder.

³ *Eustace v. Dublin Trunk Ry. Co.*, 6 Eq. 182. ⁴ *McEuen v. West London Wharves*, 6 Ch. 655.

But see *Midland, etc. Ry. Co. v.* ⁵ *Supra*, § 181.

template that the subscribers of the incorporation paper shall by subscription agree to take shares, still there is nothing illegal in their doing so;¹ but in that case it would seem that no other effect should be given to the subscription than attaches to agreements to take shares made prior to incorporation otherwise than by signing the incorporation paper.

§ 239. **Withdrawal of Signer before Registration of Instrument.** — Before the paper is recorded, obviously any subscriber may, with the consent of all his co-subscribers, retract or cancel his subscription. Until registration, all is *in fieri*.² It has been held, however, in some cases that without the unanimous consent of the subscribers one of their number cannot withdraw even before the paper is recorded;³ but in other cases, the contrary has been held.⁴ If it be law — and we shall see that some authorities so hold — that a promise to take shares in a company about to be formed cannot be retracted without the consent of the other promoters, then *a fortiori* a subscriber of an incorporation paper cannot revoke his agreement to become a stockholder, even prior to the recording of the instrument. Indeed, even if it be held that ordinarily a promise to take shares in a company to be subsequently incorporated is revocable at the pleasure of the promisor, a different rule might be applied where the promise is made by subscribing a document which is to be recorded as the company's incorporation paper.

§ 240. **Effect of Altering Instrument before Registration without Signer's Consent.** — A material alteration in the paper without the consent of one of the subscribers will no doubt release him,⁵ and may even have the effect of vitiating the incor-

¹ *Heaston v. Cincinnati, etc. R. R. Co.*, 16 Ind. 275; 79 Am. Dec. 430; *burg, etc. R. R. Co.*, 78 Pa. St. 465; *Coppage v. Hutton*, 124 Ind. 401 (holding that where paper is required to be acknowledged, a person who has signed but not acknowledged it is not bound); *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738, 740; 17 S. E. 305 (same point as last case).

² Cf. *Squires v. Brown*, 22 How. Pr. (N. Y.) 35.

³ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316, 328; *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451.

⁴ *Auburn Bolt Works v. Shultz*, 143 Pa. St. 256; *Muncy Traction Engine Co. v. Green*, 143 Pa. St. 269; 13 Atl. 747; *Garrett v. Dills-*

⁵ *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738; 17 S. E. 305.

Cf. *Felgate's Case*, 11 L. T. 613.

poration.¹ So, a person who signs a blank piece of paper and above whose signature articles of incorporation are filled in is not bound.² Indeed, the cases go much further than this. For if when the defendant signs the paper there is any material blank which is afterwards filled up without his authority, he is not bound.³ And a blank in respect to any of the matters required by the incorporation law to be stated in the paper is deemed to be material.⁴

§ 241. **Effect of Registration without Signer's Authority.** — On the other hand it has been held that a person who signs an incorporation paper for a certain number of shares will be liable as a shareholder even though he intended that the instrument should have the effect of an escrow merely, and although it was recorded without waiting for performance of the condition.⁵

§ 242. **Signer irrevocably bound when Instrument is duly recorded.** — As soon as the incorporation paper, as signed, is duly recorded, each subscriber is irrevocably bound to accept the number of shares in respect of which he signed the same.⁶ In order to complete his obligation, there is no need of acceptance by the company or of any allotment of shares.⁷ Whether or not such a subscriber is an actual shareholder from the moment of the incorporation of the company is a question which has received consideration above.⁸ The fact that some condition precedent to incorporation, such as the filing of a certificate with the secretary of state, is omitted so that the company never becomes a corporation *de jure* will not, it has been held, release the subscriber.⁹ The company has no power to release a subscriber of

¹ See *supra*, § 143.

² *Bucher v. Dillsburg, etc. R. R. Co.*, 76 Pa. St. 306.

³ *Dutchess, etc. R. R. Co. v. Mabbett*, 58 N. Y. 397; *Consols Ins. Ass'n v. Newall*, 3 Fost. & F. 130 (where the blank related to the number of shares which the subscriber was to take).

⁴ *Dutchess, etc. R. R. Co. v. Mabbett*, 58 N. Y. 397.

⁵ *Rehbein v. Rahr*, 109 Wisc. 136; 85 N. W. 315. See *supra*, § 129.

⁶ In addition to cases cited *infra*, see *Rathbone v. Ayer*, 105 N. Y. Supp. 1041.

⁷ *Evans' Case*, 2 Ch. 427; *Sidney's Case*, 13 Eq. 228; *Haggert Bros. Mfg. Co.*, 19 Ont. App. 582.

⁸ *Supra*, § 164.

Cf. *Lord Lurgan's Case* (1902), 1 Ch. 707, 709, where Buckley, J., said: "There is no executory contract which is subsequently executed. There is no contract at all until the moment when the corporation and the character of membership in the signatories to the memorandum come simultaneously into existence."

⁹ *McCarter v. Ketcham*, 72 N. J. Law 247 (headnote inadequate);

the incorporation paper from this obligation to take shares therein;¹ and consequently even a subscriber who has been permitted to sever his ostensible connection with the company and has been treated for years as if he were not a member, is nevertheless still bound by his obligation to take the shares.² If, however, the company has issued the whole of its authorized capital to other persons, then the subscriber of the incorporation paper is released from his obligation to take shares.³ This is either because the company is not in a position to carry out its correlative obligation to issue the shares, or because the shares which the subscriber agreed to take may be deemed to have been virtually transferred by him to the persons to whom the company allotted them.⁴

§ 243. **Whether Signer can avoid Subscription for Fraud.**—An agreement to take shares entered into by executing the incorporation paper of a projected company cannot, at least in England, be rescinded for fraud on the part of the promoters.⁵ For if it could, the substratum of the company would be cut away; and as there might then be less than the minimum number of corporators required by the statute, the incorporation might be vitiated. Hence, for the protection of innocent persons who may deal with the company, it is necessary to compel the corporators to take the shares in spite of the fraud by which they were induced to do so.

62 Atl. 693; *McCarter v. Ketcham* (N. J.), 67 Atl. 610 (headnote inadequate); *Cayuga Lake R. R. Co. v. Kyle*, 64 N. Y. 185. Cf. *infra*, § 260.

¹ *London & Provincial Coal Co.*, 5 Ch. D. 525; *Ex parte Watson*, 54 L. T. 233.

² *Sidney's Case*, 13 Eq. 228; *Ex parte Watson*, 54 L. T. 233; *Scottish Security Co.'s Rec'r v. Starks* (Ky.), 78 S. W. 455 (headnote inadequate); 25 Ky. Law Rep. 1722; *Haggert Bros. Mfg. Co.*, 19 Ont. App. 582.

But see *O'Brien v. Fulkerson*, 75 Mich. 554; 42 N. W. 979.

³ *Mackley's Case*, 1 Ch. D. 247. Cf. *Somerset Nat. Banking Co. v. Adams*, 72 S. W. 1125; 24 Ky. Law

Rep. 2083 (holding that where certain members of a company subscribe for all the capital of a new corporation with the intention of distributing it *pro rata* among the other members of the old company, any of those other members who subsequently agree with the new company to take their proportion of its capital are bound by their subscription).

⁴ But, as to this theory of implied transfer, see *Ex parte Watson*, 54 L. T. 233. See also *infra*, § 869.

⁵ *Lord Lurgan's Case* (1902), 1 Ch. 707.

But see *Wert v. Crawfordsville, etc. Turnpike Co.*, 19 Ind. 242; *Metropolitan Lead & Zinc Co. v. Webster*, 193 Mo. 351; 92 S. W. 79.

§ 244-§ 248. *Obligations of Subscriber in other Respects.*

§ 244. **In general.** — The obligation of subscribers of an incorporation paper, in the absence of special arrangement, is to pay the par value of the shares for which they subscribed, in instalments when called in by the directors. In other words, the obligation is the same as that which, in the absence of special agreement, attaches to any other shareholder. On the other hand, the fact that the company may require from other persons who agree to become shareholders a payment on allotment does not oblige the directors to exact a like payment from the signatories of the incorporation paper on the allotment to them of the shares in respect of which they signed that instrument.¹

§ 245. **Special Agreements with Company as to Time and Mode of Payment.** — Although *prima facie* the obligation of signatories of the incorporation paper is to pay for the shares they have agreed to take in cash on call by the directors, yet the time and mode of payment may be regulated by agreement entered into between the corporation and the signatory. For example, in the absence of prohibitory statutes, the company may agree with the subscriber that payment shall be made by transfer of property — lands, chattels, good will, etc. — in lieu of cash; and a transfer in accordance with such agreement, unless it be impeachable for fraud, will completely satisfy the signatory's obligation.² A statute, however, which requires shares to be paid for in cash unless a contract stipulating for some different mode of payment shall have been recorded prior to their issue has been held to necessitate in all cases payment in cash by subscribers of the incorporation paper;³ for, it

Cf. *Squires v. Brown*, 22 How. Pr. 1041 (where the valuation of property taken in payment was held to be unreasonably excessive and fraudulent).

¹ *Alexander v. Automatic Telephone Co.* (1899), 2 Ch. 302.

² *Jarvis's Case* (1899), 1 Ch. 193

³ *Drummond's Case*, 4 Ch. 772; (semble); *Dalton Time Lock Co. v. Pell's Case*, 5 Ch. 11; *Baglan Hall Dalton*, 66 L. T. 704; *Ebenezer Colliery Co.*, 5 Ch. 346; *Jones's Timmins & Sons, Ltd.* (1902), 1 Ch. Case, 6 Ch. 48; *Maynard's Case*, 238.

9 Ch. 60.

Cf. *Fothergill's Case*, 8 Ch. 270;

Cf. *Dieterle v. Ann Arbor Paint, Re Archibald D. Dawney, L't'd*, 83 etc. Co., 107 N. W. 79; 143 Mich. L. T. 47.

416; *Rathbone v. Ayer*, 105 N. Y.

was reasoned, the shares subscribed for in that instrument are deemed to be issued at the very moment of incorporation¹ so that in the nature of things no contract stipulating for payment otherwise than in cash could be registered antecedent to the issue.

§ 246. **Whether Shares allotted and paid for after Incorporation satisfy Obligation incurred by signing Incorporation Paper.**—Where, after the company is organized, a signatory of the incorporation paper applies for shares in the ordinary way, and the same are allotted to him, if it be proved even by parol that the shares so allotted were intended by all parties to include, or be the same as, the shares which the applicant agreed to take by subscribing the incorporation paper, effect will be given to such intention; and the allotment of the shares so applied for will be held to satisfy the obligation created by signing the incorporation paper.² Indeed, it has been said that in such a case the burden of proof is on the company or its liquidator or receiver to show that there were really allotted to the subscriber, and that the latter did accept additional shares besides those in respect of which he signed the incorporation paper.³ Where in signing the incorporation paper, the signatory was really acting on behalf of a partnership of which he was a member, his obligation is satisfied by an allotment of the stipulated number of shares to that firm.⁴

On the other hand, the obligation of the signatory is to take shares from the company, and cannot be satisfied by taking shares by transfer from another shareholder or even by taking, as the nominee of another person, shares which the latter has contracted with the company to take.⁵

§ 247. **Whether Subscription for Preferred Shares satisfied by taking and paying for Common Shares.**—Where a signatory of an incorporation paper agrees by his subscription to take preference shares, his obligation, it has been held, may be satisfied by taking with the company's assent an equal number of ordi-

¹ See *supra*, § 164, where the correctness of this premiss is questioned.

² *Gilman's Case*, 31 Ch. D. 420; *Drummond's Case*, 4 Ch. 772; *Pell's Case*, 5 Ch. 11; *Maynard's Case*, 9 Ch. 60.

But see *Currie's Case*, 11 W. R. 46.

³ *Maynard's Case*, 9 Ch. 60, 68, per Mellish, L. J.

⁴ *Dunster's Case* (1894), 3 Ch. 473.

⁵ *Forbes & Judd's Case*, 5 Ch. 270. Cf. *Migotti's Case*, 4 Eq. 238.

nary shares.¹ The *ratio decidendi* of this case — to wit, that the Companies Act does not require any distinction to be made in the memorandum of association or incorporation paper between preferred and ordinary shares, and that the instrument may be altered in respect to matters not required by the statute to be mentioned therein — is not in accord with the later cases;² but nevertheless it is submitted that the actual decision is sound and would be followed.

§ 248. **Subscription of Incorporation Paper for Shares to be issued as fully paid without Payment in full.** — It is true, that a corporation's executory promise to issue paid-up shares cannot be satisfied by the issue of shares which in law are not fully paid.³ Nevertheless, where an incorporation paper states that the shares which the subscribers agree to take shall be credited as fully paid although no money or money's worth may have been given therefor, it would seem clear that the signatories are bound notwithstanding to pay for the shares which by their subscription of the instrument they agree to take.⁴ However, where a person subscribes an incorporation paper for some shares which shall be issued subject to the usual obligation of payment of their par value in cash, and also for other shares which, it is stated, shall be issued as fully paid, it has been held in England that he cannot be required to pay for the latter shares.⁵ The reason for this distinction, if indeed it be sound, must be that the subscriber can perform his function as a corporator if he be bound to take and pay for *any* shares, and that the agreement to take the additional shares to be issued as paid-up is surplusage. However, the soundness of the distinction may be questioned. For instance, in Pennsylvania where a subscriber to an incorporation paper appeared on the face of the instrument to have subscribed for 100 shares, it was held that in spite of a contemporaneous oral agreement that all except five shares should be turned back to the company as "treasury stock" without any payment by the subscriber, he was nevertheless bound to pay for the full one hundred shares, and that too although the suit did not appear to be prosecuted for the benefit of creditors, and

¹ *Duke's Case*, 1 Ch. D. 620.

² *Supra*, § 120, § 144.

³ *Infra*, § 778, § 789. See also 238.
supra, § 184 and § 233.

⁴ *Baron de Beville's Case*, 7 Eq. 11 (semble). Cf. *Migotti's Case*, 4 Eq.

⁵ *Baron de Beville's Case*, 7 Eq. 11.

although there was no allegation of a deficiency of assets;¹ but, certainly, this decision was based more upon the peculiar phraseology of the Pennsylvania statute than upon general principles of law applicable to subscriptions to shares made by signing an incorporation paper.

§ 249-§ 260. *Agreements made prior to Incorporation otherwise than by signing the Incorporation Paper.*

§ 249. **Nature and Effect in general — Revocability.** — The third and last class of agreements to take shares comprises agreements made with or between promoters prior to the incorporation of the company otherwise than by subscribing the incorporation paper.² Agreements of this sort differ from agreements made by signing the incorporation paper in that they are not so clearly or necessarily part of the statutory scheme for the organization of the corporation.³ If they are to be governed by the general principles of the law of contracts, the company upon attaining corporate existence has no right to enforce them unless they first be adopted or accepted by it. To be sure, it is sometimes thought that the principle prevailing in some of the United States, which permits the beneficiary of a contract to which he is a stranger to maintain an action thereon, is broad enough to entitle the corporation to enforce a promise made to its promoters to take shares of its capital stock.⁴ But the corporation, while undoubtedly deriving benefit from the contract, is certainly not the sole beneficiary thereof, since the other shareholders and promoters have a great interest in its enforcement; and the better view is that the corporation has no right to enforce such a contract.⁵ Like other contracts made by promoters on behalf of a corporation to be subsequently organized,

¹ *Greater Pittsburg Real Estate Co. v. Riley*, 210 Pa. St. 283; 59 Atl. 1068.

² As to the liability of promoters to the subscriber on such contracts, see *Feitel v. Dreyfous* (La.), 42 So. 259; 117 La. 756 (where the promoters were exonerated from liability, because they had not accepted the subscriber's application).

³ Cf. *Peninsular Ry. Co. v. Duncan*, 28 Mich. 130.

⁴ *Marysville, etc. Co. v. Johnson*, 93 Cal. 538, 548; 29 Pac. 126; 27 Am. St. Rep. 215; *Glenn v. Buscy*, 5 Mack. (D. C.) 233, 238-239; 1 Morawetz on Priv. Corps., § 50. Cf. *Hamilton, etc. Co. v. Rice*, 7 Barb. (N. Y.) 157; *Eastern Plank Road Co. v. Vaughan*, 14 N. Y. 546, 555. But see 2 Clark & Marshall on Priv. Corps., § 443, p. 1379.

⁵ *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219.

such an agreement may undoubtedly operate as an offer which the company when incorporated may accept;¹ but if this be its only operation as regards the corporation, it is revocable by the subscriber so far as the corporation is concerned at any time before the company is incorporated and accepts the offer. In England, there seems to be no doubt that this is the law with respect to corporations formed under the Companies Acts;² and the same rule is supported by the weight of authority in the United States.³ The right of revocation exists although the subscription is under seal, so that lack of consideration would be no defence.⁴ Withdrawal is allowed not only because the sub-

¹ *Athol Music Hall Co. v. Carey*, 116 Mass. 471; *San Joaquin, etc. Co. v. Beecher*, 101 Cal. 70; 35 Pac. 349; *Buffalo, etc. R. R. Co. v. Clark*, 22 Hun (N. Y.) 359; *Richelieu Hotel Co. v. International, etc. Encampment Co.*, 140 Ill. 248; 29 N. E. 1044; 33 Am. St. Rep. 234; *Yonkers Gazette Co. v. Taylor*, 30 N. Y. App. Div. 334; 51 N. Y. Supp. 969; *Bryant's, etc. Mill Co. v. Felt*, 87 Me. 234; 32 Atl. 888; 47 Am. St. Rep. 323; 33 L. R. A. 593; *Badger Paper Co. v. Rose*, 95 Wisc. 145, 151-152; 70 N. W. 302; 37 L. R. A. 162; *Avon Springs Sanitarium Co. v. Weed*, 104 N. Y. Supp. 58.

But cf. 1 Morawetz on Priv. Corps., 2d ed., § 49, where the opinion is expressed that a contract to subscribe for shares in a corporation to be subsequently formed, contemplates that the parties before becoming shareholders shall perform a further act, namely, execute the statutory contract of membership by subscription upon the stock-books, and therefore does not constitute an offer which the corporation can accept. *Sed quære*. Cf. *Coyote, etc. Co. v. Ruble*, 8 Oreg. 284; *Coppage v. Hutton*, 124 Ind. 401; 24 N. E. 112; 7 L. R. A. 591; *Troy, etc. R. R. Co. v. Tibbits*, 18 Barb. (N. Y.) 297; *Sedalia, etc. Ry. Co. v. Wilkerson*, 83 Mo. 235; *Yonkers Gazette Co. v. Taylor*, 30 N. Y. App. Div. 334; 51 N. Y. Supp. 969;

Woods Motor Vehicle Co. v. Brady, 39 N. Y. Misc. 79; 78 N. Y. Supp. 203; *Cleveland v. Mullin*, 96 Md. 598; 54 Atl. 665

In *Lake Ontario Shore R. R. Co. v. Curtiss*, 80 N. Y. 219, an agreement between third persons that each should subscribe to stock in a corporation then forming was held not to contemplate acceptance by the company and not to be enforceable at its suit.

² So in Canada. *London Speaker Printing Co., Pearce's Case*, 16 Ont. App. 508.

³ *Poughkeepsie, etc. Co. v. Griffin*, 24 N. Y. 150; *Bryant's, etc. Mill Co. v. Felt*, 87 Me. 234; 32 Atl. 888; 47 Am. St. Rep. 323; 33 L. R. A. 593; *Hudson Real Estate Co. v. Tower*, 156 Mass. 82; 30 N. E. 465; 32 Am. St. Rep. 434; s. c., 161 Mass. 10; 36 N. E. 680; 42 Am. St. Rep. 379; *Stuart v. Valley R. R. Co.*, 32 Gratt. (Va.) 146; *Carter, etc. Co. v. Hazzard*, 65 Minn. 432; 68 N. W. 74; *Sedalia, etc. Ry. Co. v. Wilkerson*, 83 Mo. 235 (where the subscriber died before the company was incorporated).

Cf. *Minneapolis Threshing Co. v. Davis*, 40 Minn. 110; 41 N. W. 1026; 3 L. R. A. 796; 12 Am. St. Rep. 701.

⁴ *Hudson Real Estate Co. v. Tower*, 156 Mass. 82, 84 (headnote inadequate); 30 N. E. 465; 32 Am. St. Rep. 434.

scriber's promise is without consideration, but also for the more fundamental reason that there is no promisee in existence. The retraction may give a right of action to the other promoters with whom the agreement was made, if a contract *inter sese* was intended; but this right of an action of the promoters or co-subscribers does not inure to the benefit of the corporation. The withdrawal need not be communicated to all the promoters or co-subscribers, but is complete upon communication to the chief officer of the preliminary organization preparatory to incorporation.¹ According to the principle that the ante-incorporation agreement operates only as an offer, the company upon its incorporation is not bound to allot the shares in accordance therewith.²

§ 250. **Doctrine that Ante-incorporation Subscriptions are Irrevocable.** — On the other hand, all modern corporations derive their existence, directly or indirectly, from statutes; and if the legislature in those statutes should expressly or impliedly enact that promises to take shares in a corporation to be subsequently formed should be incapable of revocation by the promisor, effect must of course be given to that legislative intent. The question is, therefore, whether the courts can discern such an intention in the incorporation laws. In the case of special acts of incorporation, this is more easily done. For example, even in England, a special act incorporating certain named individuals and all other subscribers to the capital of the projected company has been held to make all subscribers members of the company, even though some of them had attempted to withdraw their subscriptions before the passage of the act.³ In the case of general laws or enabling acts, the intention that ante-incorporation subscriptions to the capital shall be binding is not so readily discernible. In England, for instance, under the Companies Acts, and in some of the United States under the general incorporation laws, such a subscription would, as stated above, be held to be revocable at the pleasure of the sub-

¹ *Hudson Real Estate Co. v. Tower*, 161 Mass. 10; 36 N. E. 680; 42 Am. St. Rep. 379. The part of the acceptance to the officers of the corporation as soon as it is formed. ² *Merrick v. Consumers Heat, etc. Co.*, 111 Ill. App. 153; *Starrett v. Rockland, etc. Ins. Co.*, 65 Me. 374 (headnote inadequate). ³ *Kidwelly Co. v. Raby*, 2 Price 93. Cf. *Burke v. Lechmere*, L. R. 6 Q. B. 297.

scriber. On the other hand, inasmuch as such subscriptions preliminary to incorporation under general laws are doubtless contemplated by the incorporation acts, and inasmuch as the process of incorporation is undoubtedly somewhat facilitated by holding them to be irrevocable,¹ one need not be disposed to quarrel with a decision that they cannot be revoked without the unanimous consent of the co-subscribers.² This result is, however, more often reached upon the more questionable ground that the subscriptions constitute contracts of the several promoters *inter sese* which may be availed of by the corporation as the beneficiary notwithstanding an attempt to revoke.³

§ 251. **Subscriptions before Incorporation as Powers of Attorney to apply for and accept Shares in Corporation.** — A subscription to shares in a corporation to be formed may take the shape of, or amount to, a delegation of authority to an agent to apply for and accept the shares when the company shall have been incorporated.⁴ This form is often adopted, especially in England, in the case of underwriting agreements made before the incorporation of the company.⁵ In some cases, such powers of attorney may be made irrevocable.⁶ Somewhat similar to this is the plan sometimes adopted where several persons bind themselves to pay the amount of their subscriptions to a designated person as trustee, who is to turn the money over to the corporation when incorporated in exchange for its shares. In such cases, the trustee may maintain an action against any subscriber who refuses to pay.⁷

¹ Cf. *Lowville, etc. R. R. Co. v. Elliot*, 101 N. Y. Supp. 328.

² *Johnson v. Wabash, etc. Co.*, 16 Ind. 389 (but with this case compare *Coppage v. Hutton*, 124 Ind. 401); *Nebraska Chicory Co. v. Lednicky* (Nebr.), 113 N. W. 245.

Cf. *Peninsular Ry. Co. v. Duncan*, 28 Mich. 130.

But if a subscription contains special terms not provided for in the incorporation law, then very clearly it can have no other effect than a revocable offer until the company is incorporated and accepts it. 1 *Morawetz on Priv. Corps.*, 2d ed., § 83, § 86; *Junction R. R. Co. v. Reeve*, 15 Ind. 236.

³ See *supra*, § 249.

Cf. *Cleveland v. Mullin*, 96 Md. 598; 54 Atl. 665; *Knox v. Childersburg Land Co.*, 86 Ala. 180, 183; 5 So. 578.

⁴ Cf. *Ottawa Dairy Co. v. Sorley*, 34 Can. Sup. Ct. 508 (where the agent was held to have exceeded his authority so that no contract was formed between the principal and the company).

⁵ See *infra*, § 443-§ 445.

⁶ *Infra*, § 443.

⁷ Cf. *West v. Crawford*, 80 Cal., 19; 21 Pac. 1123. As to the right of the corporation to recover money collected by such a trustee, see *infra*, § 255.

§ 252. **Doctrine that Subscriptions made before Incorporation without subscribing Incorporation Paper are devoid of all legal Effect.** — Some cases proceed upon the ground that the incorporation laws contemplate no subscriptions prior to incorporation made otherwise than by signing the incorporation paper and that therefore such ante-incorporation subscriptions must be wholly devoid of legal effect.¹ But as already intimated such decisions are contrary to the weight of authority,² inasmuch as such subscriptions prior to incorporation should have at least as much effect as other contracts made by promoters on behalf of a prospective corporation. The question is, however, altogether one of statutory construction so that general rules can do no more than determine the attitude which the courts should assume in construing the statute.

§ 253. **Attempts of Promoters to release Subscriber.** — All the authorities would agree that in any case after the company has been incorporated and the contract of subscription has become binding between it and the subscriber, the promoters to whom the subscription was made before the incorporation have no longer any authority to release the subscriber.³

§ 254. **Requisite Definiteness in Subscription before Incorporation.** — In order that an ante-incorporation subscription should have any effect, it must specify the number and par value of the shares subscribed for.⁴ In other words, it must be sufficiently definite to constitute a contract.⁵ As the company is still *in fieri* and its constitution not yet settled, greater particularity is required than in the case of an offer to take shares in an existing company, in which case, it would be unnecessary to state, for instance, the par value of the shares.

§ 255. **Right of Corporation to Deposits paid Promoters.** — A person may contract with a promoter of a projected corpora-

¹ *Poughkeepsie, etc. Plank Road Water Co. v. Beecher*, 101 Cal. 70; *Co. v. Griffin*, 24 N. Y. 150; *Coppage* 35 Pac. 349; *International Fair, etc. v. Hytton*, 124 Ind. 401; 24 N. E. Ass'n v. Walker, 83 Mich. 386; 47 112; 7 L. R. A. 591; *Speight Mfg. Co., Boulbee's Case*, 16 Ont. App. v. Lednicky, 113 N. W. 245 (Nebr.). 508, 519. See supra, § 249, § 250.

² Cf. *Sedalia, etc. Ry. Co. v. Wilkerson*, 83 Mo. 235; *Monterey, etc. R. R. Co. v. Hildreth*, 53 Cal. 123.

³ *Peninsular Ry. Co. v. Duncan*, 28 Mich. 130; *San Joaquin, etc.*

⁴ *Balfour v. Baker, etc. Co.*, 27 Oreg. 300; 41 Pac. 164.

⁵ *Woods Motor Vehicle Co. v. Brady*, 181 N. Y. 145; 73 N. E. 674.

⁶ Cf. *Avon Springs Sanitarium Co.*

tion to subscribe to shares therein; and, independently of the question whether the corporation may take advantage of such contracts and hold the subscriber, any deposits paid by the subscriber to the promoter are clearly impressed with a trust in favor of the company which may accordingly recover them from the promoter as money had and received to its use.¹

§ 256. **Effect of Failure of Company to allot Shares within Reasonable Time.** — Ante-incorporation subscribers to the capital of a company will be released unless an allotment of the shares subscribed for be made within a reasonable time after incorporation. This is undoubtedly true where such subscriptions are deemed mere offers;² and it is submitted that the same rule should hold good where they are held to be irrevocable by the subscriber.³

§ 257. **Subscription voidable for Fraud of Promoter.** — Upon whatever theory subscriptions to the capital of a projected company are to be enforced — whether because of adoption or acceptance by the company after its incorporation, or because they are deemed binding in the first instance — they are nevertheless subject to rescission for fraud or misrepresentation of the promoters to the same extent as if the company had been already incorporated.⁴

§ 258. **Effect of Departures from Original Scheme.** — Moreover, any material departures from the plan of the company as contemplated when the subscription was made will release the subscriber.⁵ For example, where the prospectus on the

v. Weed, 104 N. Y. Supp. 58 (where the subscription was held on demurrer sufficiently definite); *Nemaha Coal, etc. Co. v. Settle*, 54 Kan. 424; 38 Pac. 483; *Peninsular Ry. Co. v. Duncan*, 28 Mich. 130, 145.

¹ *San Joaquin, etc. Co. v. West*, 94 Cal. 399; 29 Pac. 785.

See *infra*, § 399.

² *Baily's Case*, 3 Ch. 592; *Carter, etc. Co. v. Hazzard*, 65 Minn. 432, 438; 68 N. W. 74.

³ But see *Burke v. Lechmere*, L. R. 6 Q. B. 297.

⁴ *Zang v. Adams*, 23 Colo. 408; 48 Pac. 509; 58 Am. St. Rep. 249;

Stewart v. Rutherford, 74 Ga. 435; 1 Morawetz on Priv. Corps., 2d ed., § 102, p. 101.

But see *Shick v. Citizens' Enterprise Co.*, 15 Ind. App. 329, 337-338; 57 Am. St. Rep. 230.

See also *supra*, § 217.

⁵ *Stern v. McKee*, 70 N. Y. App. Div. 142; 75 N. Y. Supp. 157; *West End, etc. Co. v. Nash*, 51 W. Va. 341; 41 S. E. 182; *Middlecoff Hotel Co. v. Yeomans*, 89 Ill. App. 170; *Smith v. Burns Boiler & Mfg. Co.* (Wisc.), 111 N. W. 1123; *Knox v. Childersburg Land Co.*, 86 Ala. 180; 5 So. 578 (change in law as to method of

faith of which the subscription was made states as the object of the company the working of a particular established mine in Russia, the fact that the incorporation paper when recorded justifies the working of any mine in Russia releases the subscriber.¹ A change in the period to be prescribed for the termination of the corporate existence will release a person who has agreed to take shares.² *Prima facie*, a domestic corporation is deemed to have been contemplated; and therefore in the absence of some provision showing that a foreign corporation was intended, a foreign corporation cannot claim the benefit of the subscription.³ But a mere change in the name of the projected company will have no such effect;⁴ and any change which is immaterial, and merely expresses what would otherwise be implied, does not release prior subscribers.⁵ In respect to the necessity for prompt repudiation, etc., these cases of depar-

payment for stock, held sufficient to release subscriber).

And see *Shick v. Citizens' Enterprise Co.*, 15 Ind. App. 329, 337-338; 57 Am. St. Rep. 230.

And as to cases of incorporation by special act, see *Midland, etc. Ry. Co. v. Gordon*, 16 M. & W. 804; *Nixon v. Brownlow*, 3 H. & N. 686 (where the amount of the capital and number and amount of the shares were altered).

¹ *Stewart's Case*, 1 Ch. 574; *Webster's Case*, 2 Eq. 741.

Cf. *Lawrence's Case*, 2 Ch. 412; *Peel's Case*, 2 Ch. 674; *Wilkinson's Case*, 2 Ch. 536; *Woods Motor Vehicle Co. v. Brady*, 181 N. Y. 145; 73 N. E. 674 (offer to take shares in company to deal in motor vehicles; company afterwards incorporated to manufacture and deal in automobiles); *Smith v. Burns Boiler & Mfg. Co.* (Wisc.), 111 N. W. 1123 (offer to take shares in company for manufacturing boilers, corporation formed with power to engage in general "merchandising" and general manufacturing); *Dorris v. Sweeney*, 60 N. Y. 463 (offer to take shares in company for working a certain patent for preserving fruits, company

formed for manufacture of preserved fruits and canning of fruits).

But see *Haskell v. Worthington*, 94 Mo. 560; 7 S. W. 481 (where it was said that a subscriber would not be released because incorporation paper when recorded would authorize the company to transact business in addition to that contemplated by the subscription).

² *Greenbrier Industrial Exposition v. Rodes*, 37 W. Va. 738; 17 S. E. 305.

³ Cf. *Olympia Mining Co. v. Kerns* (Idaho), 91 Pac. 92.

⁴ *Yonkers Gazette Co. v. Taylor*, 30 N. Y. App. Div. 334; 51 N. Y. Supp. 969.

Cf. *Haskell v. Worthington*, 94 Mo. 560; 7 S. W. 481.

⁵ *Union Agricultural, etc. Ass'n v. Neill*, 31 Iowa 95; *Comanche Cotton Oil Co. v. Browne* (Tex.), 92 S. W. 450 (company projected to operate a cotton seed oil mill, amendment expressly authorizing the operation of cotton-gins as feeders for the mill immaterial); *Lowville, etc. R. R. Co. v. Elliot*, 101 N. Y. Supp. 328 (company projected to build a railway; company incorporated to "build, maintain, and operate" a railway).

tures from the original scheme or project are assimilated to cases of fraud or misrepresentation.¹ But the fact that the subscriber attends a meeting of the corporation under the belief that it is a mere meeting of the promoters called to consider the propriety of accepting the incorporation paper as filed will not preclude him from withdrawing.² The departures from the original scheme may be such as to justify the conclusion that the company which was actually formed was not that in which the subscriber agreed to take shares; and in that case there would be no contract at all.³ It is not necessary that the corporation should be formed by parties to the subscription agreement.⁴ Unreasonable delay in the incorporation of the company is equivalent to a substantial departure from the original project, and will have the same effect in releasing a subscriber to the shares.⁵

§ 259. *Signer of a proposed Incorporation Paper not bound if Company incorporated under different Instrument.* — If a person signs a document which is intended to operate as an incorporation paper, he cannot be held by a company which is organized under a different paper executed by other persons.⁶ In other words, if a person intends to become a corporator, he cannot without some further act or offer on his part be held as a subscriber to the capital if the company is incorporated by other persons.

§ 260. *Whether De Facto Corporation can enforce Subscription.* — Even where the doctrine of *de facto* corporations is rec-

¹ *Ætna Ins. Co.* (1871), Ir. Rep. 181 N. Y. 145; 73 N. E. 674; *Smith* 6 Eq. 298; *Osborne Park Land & Investment Co.*, 18 Vict. L. R. 515. 111 N. W. 1123.

See also *Nickum v. Burkhardt*, 30 Oreg. 464; 47 Pac. 788; 48 Pac. 474; 60 Am. St. Rep. 822. 2 Clark & Marshall on Priv. Corps., § 439 d.

But cf. *Ship's Case*, 2 De G. J. & S. 544. Cf. *Ship's Case*, 2 De G. J. & S. 544.

² *Smith v. Burns Boiler & Mfg. Co.* (Wisc.), 111 N. W. 1123. See also *Accidental, etc. Ins. Corp. v. Davis*, 15 L. T. 182 (where the departure was held not to be of this character).

³ *Richmond Factory Ass'n v. Clarke*, 61 Me. 351 (where the subscription contemplated incorporation under a general law and the company which was actually formed was incorporated by special act); ⁴ *Avon Springs Sanitarium Co. v. Weed*, 104 N. Y. Supp. 58.

⁵ *Patterson v. Turner*, 3 Ont. L. Rep. 373.

⁶ *Richmond Street R. R. Co. v. Woods Motor Vehicle Co. v. Brady*, *Reed*, 83 Ind. 9.

ognized, a person who subscribes to shares of stock before incorporation is deemed to contemplate incorporation *de jure*; and hence according to the weight of authority, he cannot be held to his subscription by an organization which has a mere *de facto* existence.¹

¹ *Dorris v. Sweeney*, 60 N. Y. 463; *Marshall on Priv. Corps.*, § 462 e, p. 1440.
Shick v. Citizens' Enterprise Co., 15 Ind. App. 329; 57 Am. St. Rep. 230. Cf. *DeWitt v. Hasting*, 69 N. Y. 518.
Williams v. Citizens Enterprise Co., 153 Ind. 496; 55 N. E. 425; *Capps v. Hastings Prospecting Co.*, 40 Nebr. 470; 58 N. W. 956; 24 L. R. A. 259; 42 Am. St. Rep. 677; 2 Clark & But as to subscriptions made by signing the incorporation paper, see *supra*, § 242.

CHAPTER IV

IRREGULAR INCORPORATION — PROOF OF INCORPORATION

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§ 261. **Confusion in Authorities.** — Few topics in the American law of corporations are more confused than the subject of irregular or defective incorporation — of the consequences of defects, or lack of compliance with law, in the terms of the incorporation papers or in its execution or recording, or a non-observance of statutory requirements in respect to matters preceding or attending the incorporation. What are the consequences of such defects? Do they render the attempted incorporation wholly nugatory? Or does the association in spite of such irregularities become a corporation *de facto* whose existence can be questioned only on direct proceedings instituted by the sovereign? If a negative answer be given to this last question, may the persons who compose the association or who deal with it be estopped under some circumstances to deny its corporate existence? Upon these and similar questions, the law in the United States consists in a wilderness of, often, irreconcilable decisions.¹

§ 262. **Scope of Treatment.** — In the present chapter, we shall endeavor at least to clear away some of the undergrowth that obscures the approaches to the forest, without undertaking the herculean task of opening a pathway through the jungle itself. This plan of dealing with the subject is believed to be most conducive to the elucidation of the matter. For wherever the cases are so numerous and in such hopeless conflict as the American decisions on the law of *de facto* corporations and of corporations by estoppel, the most helpful and satisfactory treatment of many particular features of the law must be confined to the cases in some one state.

¹ For a thorough and scientific treatment of parts of the subject, see articles by Professor E. H. Warren, in 20 Harv. L. Rev. 456 and with full citations of authorities, 21 Harv. L. Rev. 305.

§ 263. **Diminishing Importance of Subject.** — The whole subject, one should observe, is of less importance than formerly. For the more recent incorporation laws are so simple that the irregularities or defects in the incorporation proceedings can always be avoided by the merest tyro by the exercise of the most ordinary care.

§ 264. **Non-compliance with Directory Provisions — Substantial Compliance with Law.** — It should be premised that the non-observance of provisions that can be deemed directory merely is, properly speaking, no irregularity at all, and hence may be entirely disregarded.¹ In determining whether or not a given provision should be construed as directory and not mandatory, regard should be had to the purpose of the statute. Substantial compliance and not necessarily literal compliance even with mandatory provisions is all that is requisite; and, if the statute is substantially complied with, the company becomes a corporation *de jure* as well as *de facto*.² In other words, a mere lack of literal compliance with the act is not deemed a defect or irregularity in the incorporation.

§ 265. **Breaches of Conditions Subsequent.** — Moreover, where a statute, in however mandatory terms, requires certain acts to be done *after* the attainment of corporate existence, failure to comply with that requirement will be merely a cause of forfeiture, which, according to well-known principles, in the absence of an express and emphatic statutory declaration to the contrary, can be taken advantage of only by the state on a direct proceeding instituted for that purpose.³ Thus, where a statute provides that on registration of the incorporation paper, the sub-

¹ See *Rose Hill, etc. Road Co. v. People ex rel. Lawless*, 115 Ill. 133; 3 N. E. 725; *Judah v. Am. Live Stock Ins. Co.*, 4 Ind. 333; *Newcomb v. Reed*, 12 Allen (Mass.) 362, 364 (headnote inadequate); *Braintree Water Supply Co. v. Inhabitants of Braintree*, 146 Mass. 482, 488 (headnote inadequate); 16 N. E. 420.

² *People ex rel. Bernard v. Cheeseman*, 7 Colo. 376, 379; 3 Pac. 716; *People v. Stockton, etc. R. R. Co.*, 45 Cal. 306; 13 Am. Rep. 178; *People v. Montecito Water Co.*, 97 Cal. 276; 32 Pac. 236; 33 Am. St. Rep. 172; *State ex rel. Attorney-General v. Wood*, 13 Mo. App. 139. ³ *Murphy v. Wheatley*, 102 Md. 501; 63 Atl. 62; *Hammond v. Straus*, 53 Md. 1, 12; *Baker v. Adm'r of Backus*, 32 Ill. 79; *Shakopee Mfg. Co.*, 37 Minn. 91, 93; 33 N. W. 219; *County of Macon v. Shores*, 97 U. S. 272, 277; *Brown v. Wyandotte, etc. Ry. Co.*, 68 Ark. 134; 56 S. W. 862; *Merrick v. Reynolds Engine, etc. Co.*, 101 Mass. 381; *Granby Mining Co. v. Richards*, 95 Mo. 106; 8 S. W. 246; *Hughesdale Mfg. Co. v. Vanner*, 12 R. I. 491;

scribers shall be incorporated, the non-observance of a requirement that a duplicate of the instrument shall be filed with the secretary of state can be at most a cause of forfeiture, not to be availed of collaterally.¹ So, a condition precedent to the right to commence business may be a condition subsequent to corporate existence.² The matter of conditions subsequent to incorporation relates in strictness to the dissolution of corporations, and to the termination of corporate existence; and hence any consideration of the subject in detail would be beyond the scope of this treatise.

§ 266-§ 270. CERTIFICATES BY PUBLIC OFFICERS TO REGULARITY OF INCORPORATION.

§ 266. **In general.** — Often, as shown above,³ the corporation laws provide that the incorporation paper shall be submitted to some public officer who is to determine whether or not it complies with law. Sometimes, too, this officer is required to certify his determination upon the instrument. In England, the document is submitted to the registrar of joint-stock companies, who, if he approve the paper, records the same, and thereupon issues a certificate, called a certificate of incorporation, stating that the company has complied with the law and is duly incorporated.⁴ This name, certificate of incorporation, although in itself appropriate enough, cannot conveniently be applied in America to similar certificates, because in many states the incorporation papers are called certificates of incorporation. The name, however, is immaterial: the nature of the instrument is the same. The issuance of the certificate by the registrar or other officer charged with the duty, although it furnishes the best and most convenient evidence of incorporation, is nevertheless not ordinarily a condition precedent to incorporation.⁵

Harrod v. Hamer, 32 Wisc. 162; *Ryland v. Hollinger*, 117 Fed. 216.

See also *supra*, § 137 and cases cited, and § 139.

¹ *Mokelumne Hill Mining Co. v. Woodbury*, 14 Cal. 424; 73 Am. Dec. 658. See *supra*, § 137.

² *Stokes v. Findlay*, 4 McCrary

205 (headnote inadequate); *Hammond v. Straus*, 53 Md. 1, 16.

See also *supra*, § 177.

³ *Supra*, § 139-§ 142.

⁴ Companies Act, 1862, § 18.

⁵ *Sparks v. Woodstock Iron, etc. Co.*, 87 Ala. 294; 6 So. 195. See also *supra*, § 142.

§ 267. **Whether Certificate conclusive Evidence of Regularity — Revocation of Certificate.** — The first question is whether the determination of the officer to whom the instrument is submitted that the document conforms to law is conclusive, so as to preclude anybody who may be interested from showing that the officer was mistaken, some mandatory provision of law having been disregarded. Where there is no express provision to that effect, the officer's determination is not conclusive: that is, the mere fact that the incorporation papers must be passed upon by some public official does not make his approval a conclusive determination that all legal requirements have been observed.¹ So, where a special act of incorporation provided that the company should have the right to collect tolls as soon as a certificate of its organization should be returned by certain commissioners to the governor of the state and the latter should proclaim the company to be entitled to do so, a proclamation of the governor in pursuance of the statute was held not to be conclusive evidence of incorporation, upon issue joined on a plea of *nul tiel* corporation.² Of course, however, a court may well hold that under the American doctrine of *de facto* corporations the fact of the official approval amounts to colorable compliance with law so as necessarily to make the company a corporation *de facto*

¹ *Oler v. Baltimore, etc. R. R. Co.*, 41 Md. 583, 590; *Kinston, etc. R. R. Co. v. Stroud*, 132 N. Car. 413; 43 S. E. 913 (where the official was merely charged with the duty as registrar of refusing to record an illegal instrument); *Boyce v. Trustees Townsontown Sta.*, 46 Md. 359; *People ex rel. Davenport v. Rice*, 68 Hun (N. Y.) 24; 22 N. Y. Supp. 631 (holding that registrar may decline to record the paper if not in compliance with law, notwithstanding the approval of a judge to whom the statute required the instrument to be submitted); *Hamilton, etc. Road Co. v. Townsend*, 13 Ont. App. 534.

But see *First Nat. Bank v. Rockefeller*, 195 Mo. 15 (headnote misleading); 93 S. W. 761; *Banwen Iron Co. v. Barnett*, 8 C. B. 406; *Bird's Case*, 1 Sim. N. S. 47. With

these latter cases, compare the other English cases cited *infra*, § 268.

See also *Laflin, etc. Powder Co. v. Sinsheimer*, 46 Md. 315; 24 Am. Rep. 522; *Mix v. Nat. Bank of Bloomington*, 91 Ill. 20; 33 Am. Rep. 44 (holding certificate to be *prima facie* evidence of incorporation); *Merchants' Nat. Bank v. Glendon Co.*, 120 Mass. 97 (similar point to last case).

As to the effect of a statutory provision that an official certificate shall be *prima facie* evidence of incorporation, see *Wood v. Wiley Construction Co.*, 56 Conn. 87; *Bartlett v. Wilbur*, 53 Md. 485 (holding that the same effect will be given to the certificate in a foreign state).

² *Duke v. Cahawba Nav. Co.*, 10 Ala. 82, 91 (headnote inadequate); 44 Am. Dec. 472.

in spite of any previous irregularities in the proceedings.¹ So, too, the fact that the official approval was obtained by fraudulent misrepresentations on the part of the promoters is not ground for collateral attack upon the validity of the incorporation.² This conclusion should be based not merely upon the ground that there is colorable compliance with the incorporation law but also upon the ground that there is formal compliance and that the legislature intended to require no more. The judge or officer to whom the incorporation proceedings are submitted may revoke his approval, at any rate where his error in granting the approval was so flagrant that the attempted incorporation is absolutely void.³

§ 268-§ 270. *Statutes making Certificate Conclusive Evidence of Regularity.*

§ 268. **English Cases.** — The extent to which statutory provisions purporting to make the officer's decision conclusive will be carried, of course depends very largely on their terms. The English Companies Act of 1862 provided that the registrar's issuance of a "certificate of incorporation" should be "conclusive evidence that all the requisitions of this Act in respect of

¹ *Jones v. Dana*, 24 Barb. (N. Y.) 395, 402; *Tar River Nav. Co. v. Neal*, 3 Hawks (N. Car.) 520.

² *U. S. Vinegar Co. v. Schlegel*, 143 N. Y. 537; 38 N. E. 729; *Glover v. Giles*, 18 Ch. D. 173; *Hartman v. Pennsylvania Range-Boiler Co.*, 24 Pa. Co. Ct. Rep. 324; *Duke v. Cahawba Nav. Co.*, 16 Ala. 372, 374; *Cochran v. Arnold*, 58 Pa. St. 399 (overruling *Patterson v. Arnold*, 45 Pa. St. 410); *Rice v. Nat. Bank*, 126 Mass. 300 (headnote inadequate).

Cf. *American Salt Co. v. Heidenheimer*, 80 Tex. 344; 15 S. W. 1038; 26 Am. St. Rep. 743; *Tavaglioni v. Societa Italiana*, 5 Pa. Dist. R. 441; *German Ins. Co. v. Strahl*, 13 Phila. 512; *Pattison v. Albany Bldg., etc. Ass'n*, 63 Ga. 373; *Litchfield Bank v. Church*, 29 Conn. 137, 148-149;

Haacke v. Knights of Liberty, etc. Club, 76 Md. 429; 25 Atl. 422; *Laflin, etc. Powder Co. v. Sinsheimer*, 46 Md. 315; 24 Am. Rep. 522.

But see *Jersey City Gas Co. v. Dwight*, 29 N. J. Eq. 242 (where merely colorable compliance was had with a statute making the subscription and payment of a certain proportion of the capital a condition precedent to incorporation).

³ *National Endowment Co.*, 142 Pa. St. 450; 21 Atl. 879.

But see *Illinois Watch Case Co. v. Pearson*, 140 Ill. 423, 432-433; 31 N. E. 400; 16 L. R. A. 429 (holding that the approval cannot be revoked because after it was given another corporation changed its name to one very similar to that of the new company).

registration have been complied with.”¹ The cases in which this enactment has been construed, although not altogether harmonious, constitute our chief source of enlightenment as to the effect of such provisions. Thus, where the object clause of a memorandum of association was altered after execution by the subscribers and before registration, the House of Lords held that the registrar’s “certificate of incorporation” precluded the courts from looking at such matters for the purpose of questioning the validity of the incorporation;² and, after the argument in this case but before the decision of the House, Lord Cairns pronounced a similar judgment,³ in which, however, he left the point open whether the conclusive effect given by the statute to the registrar’s certificate would deprive persons who might be injured from suing the registrar for knowingly recording an altered document.⁴ In several subsequent cases, however, the doctrine has been enunciated (although in none of them was it necessary to the decision) that the registrar’s certificate and determination that the document offered for registration complies with law does not prevent any one who may be desirous of impeaching the corporation of the company from showing that in fact less than the required number of signatures were attached⁵ — that, for example, one person had signed twice. So, in construing a similar provision in the Companies Act of 1856,⁶ it was held that the registrar’s certificate was not conclusive upon the

¹ Companies Act, 1862, § 18.

² *Oakes v. Turquand*, L. R. 2 H. L. 325, 354, 369 (headnote inadequate).

³ *Peel’s Case*, 2 Ch. 674.

⁴ 2 Ch. 682.

⁵ *National Debenture, etc. Corp.* (1891), 2 Ch. 505; *Laxon & Co.* (1892), 3 Ch. 555.

But see *Nassau Phosphate Co.*, 2 Ch. D. 610; *Bird’s Case*, 1 Sim. N. S. 47.

A statutory provision making a commissioner’s certificate conclusive evidence that a charge upon the company’s lands to secure a loan is valid relates merely to matters of procedure and does not validate a loan which is *ultra vires* of

the corporation. *Wenlock v. River Dee Co.*, 38 Ch. D. 534. As to other provisions making certificates of public officers “conclusive evidence” of regularity in corporate affairs, see *Ladies Dress Ass’n v. Pulbrook* (1900), 2 Q. B. 376, and *infra*, § 588 and § 646.

⁶ 19 & 20 Vict., c. 47, § 115. “The certificate of incorporation given to any existing company, in pursuance of this act, shall be conclusive evidence that all the requisitions herein contained in respect of registration under this act have been complied with, and the date of such certificate shall be deemed to be the date at which the company is incorporated under this act.”

question whether the company was such a company as was authorized to be incorporated under the act.¹

The Companies Act of 1900 uses broader language than the Act of 1862, providing that "a certificate of incorporation given by the registrar in respect of any association shall be conclusive evidence that all the requisitions of the Companies Acts in respect of registration and of matters precedent and incident thereto have been complied with, and that the association is a company authorized to be registered and duly registered under the Companies Acts";² and this provision is believed in England, no doubt with good reason, to shut off all inquiry into alleged irregularities in the proceedings, in so far at least as those irregularities might be used as a ground for attacking the validity of the incorporation.³

§ 269. **American Cases.** — In the United States, statutory provisions having the same objects as the sections of the Companies Acts discussed in the last paragraph are frequently encountered. Probably, in such cases, the English decisions would be followed. But the circumstance should never be lost from sight that in England the intention of the legislature is the sovereign criterion, while in the United States that intention must be disregarded if it conflict with any constitutional limitation. Thus, where some American statute directs that the incorporation paper shall be submitted for examination to one of the judges whose approval shall be conclusive evidence of its conformity to law, the questions at once arise whether the duty so imposed on the judge is judicial in nature, and whether it is competent for the legislature to enact that an *ex parte* decision shall conclude the rights of persons who have had no opportunity to be heard upon the question. Of course, it is not intended to intimate that such objections are sound or insuperable.

Indeed, as already intimated, the American authorities indicate that, here as in England, the courts will effectuate whatever

¹ *Northumberland & Durham Dist. Banking Co.*, 2 De G. & J. 357, distinguished in *Ennis & West Clare Ry. Co.*, 3 L. R. Ir. 94, where the statute which was construed expressly provided that the registrar's certificate should be conclusive evidence that "the company was authorized to be registered under this act."

² Companies Act, 1900 (63 & 64 Vict., c. 48), § 1.

³ 1 Lindley on Companies, 6th ed., 151-152.

is shown to be the clear legislative intent upon these matters.¹ Thus, where a state statute relating to the consolidation or amalgamation of railway companies provided that a copy of the articles of consolidation certified by the secretary of state, in whose office they were required to be filed, should be conclusive evidence of the consummation of the consolidation, the United States Supreme Court held that the corporate existence of the amalgamated company could not be impeached by a shareholder in one of the constituent corporations upon the ground that some required precedent formality had been omitted.² So, the section of the National Bank Act providing for the conversion of state into national banks declares that upon the issuance by the comptroller of a certificate that the bank has complied with the provisions of the federal law the association shall thenceforth be deemed a national bank; and the Supreme Court held that this certificate having been given precluded a shareholder from impeaching the validity of the incorporation under the national law by showing that the owners of two-thirds of the stock had not, as required by the Act of Congress, assented to the change.³

The whole question is of less importance in the United States than in England because of the prevalence of very liberal doctrines in this country as to *de facto* corporations and "corporations by estoppel."

§ 270. **Whether Certificate precludes direct Attack by the State upon Validity of Incorporation.** — Even the most express statutory declaration that a public officer's approval of the incorporation papers shall be conclusive evidence of the due formation of the company will not prevent a direct attack upon its corporate existence by the sovereign power by *scire facias*, *quo warranto*, or other similar proceeding. That the American courts will so hold, there can be little doubt.⁴ The same result would

¹ In addition to cases cited below, see *American Order Scottish Clans v. Merrill*, 151 Mass. 558; 24 N. E. 918; 8 L. R. A. 320.

² *Leavenworth v. Chicago, etc. Ry. Co.*, 134 U. S. 688 (headnote inadequate); 10 Sup. Ct. 708.

³ *Casey v. Galli*, 94 U. S. 673 (headnote inadequate).

Cf. *Clement v. U. S.*, 149 Fed.

305 (as to conclusiveness of certificate of renewal of period of corporate existence of national bank).

As to conclusive effect of certificates of increase or reduction of capital, see *infra*, § 588 and § 646.

⁴ *Leavenworth v. Chicago, etc. Ry. Co.*, 134 U. S. 688, 700-701; 10 Sup. Ct. 708 (semble).

be reached in England if only the law provided some method of impeaching the validity of an incorporation under the Companies Acts by means of a direct proceeding instituted by the crown.¹

§ 271-§ 283. PROOF OF INCORPORATION.

§ 271. **Statement of Question.** — The most orderly and instructive method of examining the various problems regarding irregularities in incorporation is by a consideration of the following question: when one party to an action or suit is desirous of proving that a certain association of individuals is incorporated under a general law or companies act, while his opponent is correspondingly interested in negating that fact, what will be sufficient evidence of due incorporation?

§ 272. **Necessity for raising Issue by the Pleadings.** — But before attempting to answer this question, the obvious legal principle should be adverted to, that the issue of incorporation *vel non* must in some way be raised upon the pleadings,² otherwise no evidence upon that question will be necessary or admissible. Thus, if at common law, in an action of trespass brought

¹ See *Salomon v. Salomon & Co.* (1897), A. C. 22, 30; *Reuss v. Bos*, L. R. 5 H. L. 176, 193.

² See *Society for the Propagation of the Gospel v. Town of Pawlet*, 4 Pet. 480 (corporate existence of plaintiff admitted by general issue plea to writ of entry); *Bristol, etc. Trust Co. v. Jonesboro, etc. Trust Co.*, 101 Tenn. 545; 48 S. W. 228; *Taylor v. Portsmouth, etc. Ry. Co.*, 91 Me. 193, 199; 39 Atl. 560; 64 Am. St. Rep. 216; *Herald Shoe Co. v. Oklahoma Pub. Co.*, 79 Pac. 111 (Okla.) (where a general appearance for defendant was held to preclude a denial that the defendant was incorporated); *Emerson Co. v. Nimocks*, 88 Fed. 280 (denial of all knowledge of plaintiff corporation not sufficient in an equity case); *Pittsburgh, etc. Ry. Co. v. Lightheiser* (Ind.), 78 N. E. 1033, 1037 (general appearance admission of defendant's incorporation); *Simon v.*

Calfee (Ark.), 95 S. W. 1011; *Montgomery v. Seaboard Air Line Ry. Co.*, 73 S. Car. 503; 53 S. E. 987; *Chicago, etc. Ry. Co. v. State* (Ark.), 106 S. W. 199 (denial that plaintiff was a corporation owning a railway held bad as a negative pregnant).

As to what is a sufficient *allegation* of incorporation, see *Swing v. Consolidated Fruit Jar Co.* (N. J.), 63 Atl. 899; and *infra*, § 464; and 5 Enc. of Pl. & Pr., pp. 75-77, tit. "Corporations, IV, 3 (b)."

A body which sues or is sued as a corporation need not, according to the weight of authority, be *alleged* to be such. See *Leader Printing Co. v. Lowry*, 9 Okl. 89; 59 Pac. 242; *Central Bank v. Knowlton*, 12 Wisc. 624; 78 Am. Dec. 769; *Ryan v. Farmers' Bank*, 5 Kans. 658; 5 Enc. of Pl. & Pr., pp. 70-74, tit. "Corporations, IV, 3 (a)," where a large number of authorities, pro and con, are cited.

by an alleged corporation, the defendant should plead in confession and avoidance only, he would admit the plaintiff's incorporation, and could not at the trial put the plaintiff upon proof thereof. How it is necessary to plead in order to raise the question whether a certain association is incorporated is a question that belongs to the law of pleading.¹ In this place, all that is appropriate on the question is a word of caution lest the importance should be overlooked of shaping the pleadings in such a way as, under the *lex fori*, to raise the issue whether the company is incorporated. Of course, a party who alleges in his pleadings that a certain company is incorporated cannot be allowed to change front and claim that there is no such corporation.² An admission in the pleadings that "the defendant is a corporation" will be construed to mean that the defendant was incorporated, not merely at the time of action brought, but also at the time of the transactions on account of which the suit was brought.³

§ 273. **Direct Proof of Incorporation.** — From what has been said above,⁴ it is apparent that the production of a certificate from a public officer, if such there be, charged with the duty of passing finally and conclusively upon the regularity of proceedings looking to incorporation is the simplest evidence that the association in question is a corporation.⁵ But if the law

¹ See cases cited *supra*, p. 226, n. 2, and 1 Chitty on Pleading, 16th Am. ed., star page 464, note; 5 Enc. of Pl. & Pr., pp. 77-90, tit. "Corporations, IV, 3 (c)."

² *First Nat. Bank v. Dovetail, etc. Gear Co.*, 143 Ind. 534; 42 N. E. 924. Cf. *Wallace v. Loomis*, 97 U. S. 146.

³ *Legrand v. Manhattan Mercantile Ass'n*, 80 N. Y. 638 (headnote inadequate).

But see *Maryland Tube Works v. West End Improvement Co.*, 87 Md. 207, 213 (headnote inadequate), where an admission of the incorporation of the plaintiff contained in an agreed statement of facts was construed as merely an admission that the company was incorporated at the time of the agreement, and

not as precluding the defendant from insisting on an objection, raised in the answer, that the company was not incorporated at the time of the transactions referred to.

⁴ *Supra*, § 268 and § 269.

⁵ Cf. *Mix v. Nat. Bank of Bloomington*, 91 Ill. 20; 33 Am. Rep. 44 (holding comptroller's certificate under National Bank Act that the provisions of the law have been complied with, and that the association is authorized to commence business, to be competent evidence of incorporation); *Merchants' Nat. Bank v. Glendon Co.*, 120 Mass. 97 (similar point to last case).

A certificate by a public official stating that he *had* previously issued a certificate of the due incorporation of the company is not

under which the company is formed makes no provision for such a final and conclusive certificate, or if for any other reason such a certificate is not forthcoming, resort must be had to the less terse and decisive proof. The only other direct proof is the production of an incorporation paper in legal form,¹ or a certified copy thereof,² together with evidence of registration³ and of compliance with all provisions of the incorporation law,⁴ and followed up by evidence of the identity of the association whose

equivalent to the latter certificate, and indeed is not admissible in evidence. *Wall v. Mines*, 130 Cal. 27, 38-39; 62 Pac. 386. Cf. *Petty v. Hayden*, 88 N. W. 339; 115 Iowa 212.

¹ *Fortin v. U. S. Wind, etc. Pump Co.*, 48 Ill. 451; 95 Am. Dec. 560; *Edelhoff v. State*, 5 Wyo. 19, 23-25; 36 Pac. 627 (holding that original instrument is admissible although certified copy is expressly made evidence by statute); *Sumter Tobacco Warehouse Co. v. Phœnix Ins. Co.* (S. Car.), 56 S. E. 654 (same point as last case — headnote inadequate); *Sierra Land, etc. Co. v. Bricker* (Cal.), 85 Pac. 665.

Cf. *Plank Road Co. v. Young*, 12 Md. 476 (where "letters patent" issued by the governor of another state, and purporting to be in conformity with its laws, were held *prima facie* evidence of incorporation); *Agnew v. Bank of Gettysburg*, 2 H. & G. (Md.) 478 (same point as last case).

² Cf. *Fresno Canal, etc. Co. v. Warner*, 72 Cal. 379; 14 Pac. 37 (certified copy of certified record copy admitted); *Spring Valley Water Works v. San Francisco*, 22 Cal. 434; *Walker v. Shelbyville, etc. Turnpike Co.*, 80 Ind. 452 (original instrument lost); *Washer v. Allensville, etc. Turnpike Co.*, 81 Ind. 78 (original instrument lost); *Tapley v. Martin*, 116 Mass. 275, 276; *Kern v. Chicago, etc. Ass'n*, 40 Ill. App. 356 (certified copy made evidence by express statute), affirmed, 140

Ill. 371; *Dowagiac Mfg. Co. v. Higginbotham*, 15 S. Dak. 547; 91 N. W. 330; *Dooley v. Cheshire Glass Co.*, 15 Gray (Mass.) 494.

The original record is, of course, as good evidence as a certified copy. *State ex rel. Carolina Iron Co. v. Abernethy*, 94 N. Car. 545.

In *Jackson ex dem. Walton v. Leggett*, 7 Wend. (N. Y.) 377, it was said that the non-production of the original instrument must be accounted for before the record can be received.

³ *Sierra Land, etc. Co. v. Bricker* (Cal.), 85 Pac. 665 (production of original articles with "filing marks" thereon held sufficient).

The fact and date of filing with the registrar may be proved by parol. *Johnson v. Crawfordsville, etc. R. R. Co.*, 11 Ind. 280.

⁴ Cf. *Wood v. Wiley Construction Co.*, 56 Conn. 87, 97-98; 13 Atl. 137 (where a statute providing that a certified copy of the incorporation paper should be "*prima facie* evidence of the due formation, existence, and capacity of such corporation," was held to dispense with proof that after registration of the instrument a copy had been published in a newspaper as required by law).

As to the impossibility of contradicting a magistrate's certificate that the incorporation paper was duly sworn to before him, see *Dooley v. Cheshire Glass Co.*, 15 Gray (Mass.) 494 (headnote inadequate), and *infra*, § 283.

incorporation is to be proved with the association mentioned in the instrument offered in evidence.¹ User of corporate privileges under the name designated in an incorporation paper or special act of incorporation is sufficient *prima facie* evidence of identity.² If any gap or flaw appears in this chain of proof, the fact of incorporation is not impregnably established. It seems, however, to be unnecessary in the first instance to prove the genuineness of the signatures subscribed to the incorporation paper, authenticity being presumed.³

If the organization of the company by election of officers, and so forth, or by acceptance of a charter, is a condition precedent to incorporation,⁴ the books of the alleged corporation are competent evidence of those facts;⁵ but unless such regular organization be expressly prescribed as a condition precedent to incorporation, it need not be alleged, and if alleged it need not be proved, by the party having the affirmative of the issue of incorporation *vel non*.⁶

§ 274. **Indirect or circumstantial Evidence of Incorporation.** — But although direct evidence of the kind set forth in the last paragraph furnishes the most satisfactory proof of incorporation, it is not as a rule the only evidence thereof.⁷ Thus, the

¹ As to interrogating a witness whether the alleged corporation acted under certain recorded incorporation proceedings, see *Haas v. Bank of Commerce*, 41 Nebr. 754, 758-759 (headnote inadequate); 60 N. W. 85. As to proof of the identity of an association which is suing as a corporation and a certain company organized under general incorporation laws, see *M. E. Church v. Pickett*, 19 N. Y. 482, 487.

² *Came v. Brigham*, 39 Me. 35 (headnote inadequate).

Cf. *Utica Ins. Co. v. Tilman*, 1 Wend. (N. Y.) 555.

³ *New York, Lackawanna, etc. Ry. Co.*, 99 N. Y. 12; 1 N. E. 27; *Lord v. Essex Bldg. Ass'n*, 37 Md. 320, 325-326 (semble).

Cf. *Duggan v. Colorado Mortgage, etc. Co.*, 11 Colo. 113, 117 (headnote inadequate, the court declaring that evidence to prove one of the signa-

tures to be a forgery is not admissible as a ground of collateral attack on the incorporation); and *infra*, § 283.

⁴ See *supra*, § 163.

⁵ *Duke v. Cahawba Nav. Co.*, 10 Ala. 82; 44 Am. Dec. 472; *Foster v. White Cloud City Co.*, 32 Mo. 505; *Grays v. Turnpike Co.*, 4 Rand. (Va.) 578; *Buncombe Turnpike Co. v. McCarson*, 1 Dev. & B. (N. Car.) 306. See also *infra*, § 1120.

As to parol evidence of organization, etc., see *Johnson v. Okerstrom*, 70 Minn. 303; 73 N. W. 147 (where the evidence was offered for the purpose of proving the company to be a corporation *de facto*).

⁶ *Grubb v. Mahoning Navigation Co.*, 14 Pa. St. 302.

⁷ In addition to cases cited *infra*, see *Agricultural Cattle Ins. Co. v. Fitzgerald*, 16 Q. B. 432; *New York Car Oil Co. v. Richmond*, 6 Bosw.

mere fact that a company has organized and proceeded to transact business as a corporation is perhaps upon the principle *omnia presumuntur rite esse acta*, some evidence of incorporation, at least as against the company itself.¹ Certainly, where the alleged corporation is engaged in business, performance of such conditions precedent to incorporation as the commencement of business within a given time may be presumed.² So, the grant

213; *Stanford Land Co. v. Steidle*, 28 Wash. 72; 68 Pac. 178; *Fields v. U. S.*, 27 App. D. C. 433, 444-445; *Dotson v. Milliken*, 27 App. D. C. 500, 514-515.

But see *Frankland's Case*, Leigh & Cave Cr. Cas. 276, 286-287; *Welland Canal Co. v. Hathaway*, 8 Wend. (N. Y.) 480, 486; 24 Am. Dec. 51; *Warner v. Daniels*, 1 Wood. & Min. 90, 105-106; *Ulley v. Union Tool Co.*, 11 Gray (Mass.) 139; *Gauthier, etc. Co. v. Ham*, 3 Colo. App. 559, 560; 34 Pac. 484 (semble).

¹ *Narragansett Bank v. Atlantic Silk Co.*, 3 Metc. (Mass.) 282; *Doyle v. Douglas Machinery Co.*, 73 Ill. 273; *Rose Hill, etc. Co. v. People ex rel. Lawless*, 115 Ill. 133; 3 N. E. 725; *Methodist Episcopal Soc. v. Lake*, 51 Vt. 353 (where the records were lost).

Cf. *Regina v. Langton*, 2 Q. B. D. 296; *Schuyler County v. Coquard*, 9 Mo. App. 592; *Provident Institution v. Burnham*, 128 Mass. 458; *Warden, etc. of Mercers v. Hart*, 1 C. & P. 113; *Bow v. Allentown*, 34 N. H. 351; 69 Am. Dec. 489; *Wood v. Jefferson County Bank*, 9 Cow. (N. Y.) 194; *Packard v. Old Colony R. R. Co.*, 168 Mass. 92; 46 N. E. 433; *Hagerstown Turnpike Road Co. v. Creeger*, 5 H. & J. (Md.) 122; 9 Am. Dec. 495; *Sasser v. State*, 13 Ohio Rep. 453, 484-488; *Greene v. Dennis*, 6 Conn. 293 (holding that the alleged corporation had done no acts which an unincorporated association might not do).

But see *Frankland's Case*, Leigh & Cave Cr. Cas. 276.

Certain Michigan cases, *Wilson*

Sewing Machine Co. v. Spears, 50 Mich. 534; 15 N. W. 894; and *Canal, etc. Co. v. Paas*, 95 Mich. 372; 54 N. W. 907; and *Lake Superior Bldg. Co. v. Thompson*, 32 Mich. 293, were decided under a statute expressly enacting that the transaction of business under a corporate name should be *prima facie* evidence of incorporation. In *Smith v. Mayfield*, 163 Ill. 447; 45 N. E. 157, the court held that a contract with a corporation might be admitted in evidence in an action between third persons without proof of incorporation other than the user of corporate functions.

As to proof of incorporation by general reputation, see *People v. Dole*, 122 Cal. 486, 497; 55 Pac. 581; 68 Am. St. Rep. 50 (with which case compare *Norton v. State*, 74 Ind. 337, and *Nicoll v. Clark*, 13 N. Y. Misc. 128, 130; 34 N. Y. Supp. 159); *Reed v. State*, 15 Ohio Rep. 217; *Fleener v. State*, 58 Ark. 98; 23 S. W. 1; *People v. Ah Sam*, 41 Cal. 645, 651-654; *Dick v. State* (Md.), 68 Atl. 826; *State v. Brown* (Utah), 93 Pac. 52 (holding that no sufficient evidence of reputation had been adduced).

² *Bank of Manchester v. Allen*, 11 Vt. 302, 307; *Memphis, etc. Plank Road Co. v. Rives*, 21 Ark. 302 (performance of condition that subscription books be opened presumed from election of officers); *National Fire Ins. Co. v. Yeomans*, 8 R. I. 25; 86 Am. Dec. 610; *Lucas v. Bank of Georgia*, 2 Stew. (Ala.) 147, 148.

Cf. *Cheraw, etc. R. R. Co. v. White*, 14 S. Car. 51 (holding that in pleading

of a land patent to a company as a corporation followed by a deed from the company is sufficient proof of the corporate existence of the company in establishing a chain of title.¹ On the other hand, according to the weight of reason if not of authority, the use of a name such as "The Pacific Life Insurance Company of California" is not, standing alone, any evidence of incorporation;² for with equal propriety such names might be and often are borne by unincorporated associations. It has been held that the direct testimony of a witness who is acquainted with the facts to the effect that the company in question is incorporated is evidence.³

§ 275. **Secondary Evidence of Contents of Incorporation Paper.**—If the effort is made to prove incorporation, not indirectly or circumstantially, by evidence of reputation, user of corporate powers or the like, but directly by showing that an incorporation paper in compliance with law was duly executed and recorded, parol evidence of the contents of the incorporation paper will not be admissible unless the non-production of the original or a certified copy be explained.⁴ The record or certified copy is, as we have seen, generally admissible without accounting for the non-production of the original instrument.⁵ If the proper foundation be laid for secondary evidence of the contents of the incorporation paper, the court will not insist upon testimony sufficient to reproduce all the essential provisions of the instrument, but will be satisfied by general testimony that it complied with the law.⁶

performance of conditions precedent to incorporation need not be averred).

¹ *Galbraith v. Shasta Iron Co.*, 143 Cal. 94, 96 (headnote inadequate); 76 Pac. 901.

² *Briggs v. McCulloh*, 36 Cal. 542. Cf. *Guckert v. Hacke*, 159 Pa. St. 303; 28 Atl. 249 ("Hughes & Gawthrop Co."); *Owen v. Shepard*, 59 Fed. 746 (headnote inadequate—"Indian Trading Co."); 8 C. C. A. 244.

See *infra*, § 464.

³ *State v. Pittam*, 32 Wash. 137; 72 Pac. 1042; *Locke v. Leonard Silk Co.*, 37 Mich. 479.

But see *State v. Brown* (Utah), 93 Pac. 52.

⁴ Cf. *Rose Hill, etc. Road Co. v. People ex rel. Lawless*, 115 Ill. 133; 3 N. E. 725; *Owen v. Shepard*, 59 Fed. 746; 8 C. C. A. 244; *Evans v. Southern Turnpike Co.*, 18 Ind. 101; *Haas v. Bank of Commerce*, 41 Nebr. 754, 759-760; 60 N. W. 85 (holding that a witness may be asked whether the company acted under certain articles offered in evidence except that by amendment the amount of capital was changed).

⁵ *Supra*, § 273.

⁶ *Rose Hill, etc. Road Co. v. People ex rel. Lawless*, 115 Ill. 133; 3 N. E. 725.

§ 276. **Statute recognizing Corporate Existence of defectively incorporated Company.** — Any statute which recognizes the existence of an association as a body corporate, of course, dispenses with proof of incorporation and cures any defects in the incorporation proceedings,¹ unless indeed the constitution of the state prohibits special legislation having that effect. Such a statute is in effect a special act of incorporation.²

§ 277. **Admissions of Incorporation.** — Moreover, incorporation may be proved, *prima facie*, by an admission of the litigant who is denying the fact.³ And this admission may be implied as well as express. For instance, the execution of a promissory note expressed to be payable to a corporation is an implied admission by the maker that the company is incorporated;⁴ and indeed any contract or dealing with a company as a corporation is an implied admission that the company is incor-

¹ *Williams v. Union Bank*, 2 Humph. (Tenn.) 339; *Basshor v. Dressel*, 34 Md. 503; *Koch v. North Ave. Ry. Co.*, 75 Md. 222; 23 Atl. 463; 15 L. R. A. 377.

Cf. *Thornton v. Marginal Freight Ry. Co.*, 123 Mass. 32 (where there was held to be no sufficient legislative recognition of corporate existence); *Attorney-General v. Railroad Companies*, 35 Wisc. 425, 602.

² *Oroville, etc. R. R. Co. v. Palmas County*, 37 Cal. 354, 362 (headnote inadequate).

But see *Central Agricultural, etc. Ass'n v. Ala. Gold Life Ins. Co.*, 70 Ala. 120 (holding such a statute not to be a violation of a constitutional prohibition of incorporation by special act if the company is already in existence as a corporation *de facto*); *State ex rel. Sanche v. Webb*, 110 Ala. 214 (same point); *Syracuse City Bank v. Davis*, 16 Barb. (N. Y.) 188 (similar point); *State v. Squires*, 26 Iowa 340 (similar decision but on the ground that a general law could not be made applicable in such a case).

³ Cf. *Standard Oil Co. v. Commonwealth* (Ky.), 91 S. W. 1128 (receipt given by defendant company de-

scribing itself as a corporation sufficient evidence against it in a criminal case to prove its own incorporation); *Metropolitan Life Ins. Co. v. Dempsey*, 72 Md. 288; 19 Atl. 642 (paper filed as copy of company's incorporation paper although not authenticated as required by law evidence against the company to prove its incorporation); *Marz v. Raley & Co.* (Cal.), 92 Pac. 519 (letter from company admitting its incorporation sufficient evidence to support a judgment against it as a corporation).

But see *Indianapolis, etc. Co. v. Herkimer*, 46 Ind. 142, 148; *Ramsey v. Peoria, etc. Ins. Co.*, 55 Ill. 311.

As to admissions in the pleadings, see *supra*, § 272.

As to an admission in an agreed statement of facts, see *Maryland Tube Works v. West End Improvement Co.*, 87 Md. 207, 213 (headnote inadequate — stated *supra*, p. 227, n. 2).

⁴ *Jones v. Cincinnati Type Foundry Co.*, 14 Ind. 89 (headnote misleading); *Williams v. Cheney*, 3 Gray (Mass.) 215; *Brown v. Scottish-American Mortgage Co.*, 110 Ill. 235; *Williamsburg, etc. Ins. Co. v.*

porated.¹ The same has been held with respect to a mere reference to the company as incorporated in a contract with a third person.² Similarly, where a company is sued as a corporation, certificates for shares issued under the company's seal and reciting that the company had been duly registered under a general incorporation law are as against the defendant sufficient *prima facie* proof of incorporation;³ and in America the mere use by the defendant of a name such as is usually borne by a corporation would perhaps have the same effect.⁴ On the other hand, a mere admission that an account made out in the name of a supposed corporation is correct is not an admission that the creditor is incorporated.⁵ But this sort of proof, considered as merely evidentiary — that is, unless some other rule of law intervenes — is *prima facie* merely, and may be overthrown by showing that in point of fact the incorporation paper is not in correct form, or has not been recorded, or that there is some other fatal defect in the incorporation proceedings.⁶ Unless the evidence that establishes the admission is to be given some effect beyond or other than a mere admission, it is always subject to

Frothingham, 122 Mass. 391 (where a bond was in favor of a company and its successors); *Campbell & Zell Co. v. American Surety Co.*, 129 Fed. 491; *Lucas v. Bank of Georgia*, 2 Stew. (Ala.) 147, 150 (semble); *South Bay Meadow Dam Co. v. Gray*, 30 Me. 547, 549-550.

Cf. *Franz v. Teutonia Bldg. Ass.*, 24 Md. 259; *Johnston Harvester Co. v. Clark*, 30 Minn. 308; *Provident Institution v. Burnham*, 128 Mass. 458; *Gaines v. Bank of Mississippi*, 12 Ark. 769; *Williams v. Bank of Michigan*, 7 Wend. (N. Y.) 539, 541-542.

But see *Ramsey v. Peoria, etc. Ins. Co.*, 55 Ill. App. 311.

¹ *French v. Donohue*, 29 Minn. 111; 12 N. W. 354; *Johnston Harvester Co. v. Clark*, 30 Minn. 308; *Ryan v. Martin*, 91 N. Car. 464; *Griffin v. Clinton Line, etc. R. R. Co.*, 11 Fed. Cas. 27, 31; *Sierra Land, etc. Co. v. Bricker* (Cal.), 85 Pac. 665.

Cf. *Topping v. Bickford*, 4 Allen (Mass.) 120; *Williams v. Bank of*

Michigan, 7 Wend. (N. Y.) 539; *Dooley v. Wolcott*, 4 Allen (Mass.) 406.

But see *Welland Canal Co. v. Hathaway*, 8 Wend. (N. Y.) 480; 24 Am. Dec. 51.

² *Anglo-Californian Bank v. Field*, 146 Cal. 644, 651; 80 Pac. 1080.

³ *Mostyn v. Calcott Hall Mining Co.*, 1 Fos. & Fin. 334.

⁴ *Bon Aqua Imp. Co. v. Standard Fire Ins. Co.*, 34 W. Va. 764, 769-770 (headnote inadequate — where a contract of the "Standard Fire Ins. Co." was signed by "W. E., President, C. W. C., Secretary"); 12 S. E. 771. See *infra*, § 464.

⁵ *Florsheim & Co. v. Fry*, 109 Mo. App. 487, 492; 84 S. W. 1023.

⁶ *Griffin v. Clinton Line, etc. R. R. Co.*, 11 Fed. Cas. 27, 31.

Cf. *Indianapolis, etc. Co. v. Herkimer*, 46 Ind. 142 (where evidence of an admission was excluded when it appeared from other evidence that the incorporation paper had not been filed, etc.).

See also *infra*, § 283.

contradiction by bringing forward the incorporation proceedings themselves. Whether any such further effect is to be given will depend on the position taken in respect to questions which will shortly be adverted to and upon which the courts are by no means agreed.

§ 278-§ 282. ESTOPPEL TO DENY INCORPORATION.

§ 278. **Estoppel by Record.** — An estoppel partakes of the nature of a conclusive admission. Now, without entering on the vexed question of “corporations by estoppel,” one can readily perceive that an admission of corporate existence may in some cases crystallize into an estoppel to deny corporate existence. Take the clearest case — estoppel by record. If in one action or suit the question whether a certain association is legally incorporated is raised, argued, and decided in favor of the legality of the incorporation, that decision will be conclusive by estoppel in any subsequent litigation between the same parties, so as to preclude a second attack upon the company’s corporate existence.¹ On the other hand, the two actions must be between the same parties or their privies, or else the estoppel will not be available. Hence, a judgment in an action by a corporation or its receiver against one shareholder cannot be pleaded in another action by the receiver against another shareholder.²

§ 279. **Estoppel by Deed.** — As to estoppel by deed, the case is perhaps not so clear; and yet, on principle, it is difficult

¹ *Keene v. Van Reuth*, 48 Md. 184 (headnote misleading); *Williams v. Bank of Michigan*, 7 Wend. (N. Y.) 539, 541-542 (semble); *Robertson v. Parks*, 76 Md. 118, 133-134 (headnote inadequate); 24 Atl. 411.

Cf. *Estey Mfg. Co. v. Runnels*, 55 Mich. 130; 20 N. W. 823; *Fields v. Cook*, 16 La. Ann. 153; *Rush v. Halcyon Steamboat Co.*, 84 N. Car. 702, 704 (holding that after judgment against a supposed corporation, its corporate existence cannot be attacked in resisting a motion for a writ of execution); *Droege v. Emery* (Ky.), 105 S. W. 374 (similar to last case, with the further fact that the objection to the company’s corporate existence was not raised

until the claim against the individual members had become barred by limitations).

² *Nickum v. Burckhardt*, 30 Oreg. 464; 47 Pac. 788; 48 Pac. 474; 60 Am. St. Rep. 822 (where the former judgment was relied upon to establish that the company was *not* incorporated).

But see *Pochelu v. Kemper*, 14 La. Ann. 308; 74 Am. Dec. 433 (where a judgment against supposed corporation on promissory note was held to estop holder from suing members as partners). It is submitted that a better ground for this last decision is that the claim is merged in the judgment. See *infra*, § 293.

to see why a recital in a deed that a company is incorporated should not in a proper case bind the party by way of estoppel.¹ However, the authorities in general have not discriminated between estoppel by deed and estoppel *in pais*; and in fact the doctrine of estoppel *in pais* has been carried so far in respect to these matters that in most of the United States there is rarely any need of resorting to any peculiar law of estoppel by deed.

§ 280-§ 282. *Estoppel in Pais.*

§ 280. **Estoppel of Individual to deny the Incorporation.** — There seems to be no reason to doubt that on the strictest principles of the common law a person may sometimes be estopped *in pais* to deny that a certain company is a corporation. The ordinary elements of an estoppel *in pais* are well known — a statement false in fact, relied upon by another person to his prejudice. Thus, if a person either expressly, or impliedly by openly holding shares in an association which claims to be a corporation, represents to those who may choose to deal with the company that the concern is incorporated and that the shareholders are accordingly subject to any individual liability to creditors which by statute may be imposed on the stockholders of a corporation, he will be estopped to escape such liability on the plea that the company was never legally incorporated.² In such a case, all the elements of an estoppel *in pais* are present; and therefore, consistently with principle, no other decision could be reached. So, the maker of a promissory note in favor of a supposed corporate body will be estopped from denying the validity of the note in the hands of a *bona fide* holder for value, although the supposed incorporation was invalid.³ And upon the same principle, a person who executes a deed conveying

¹ *Pilbrow v. Pilbrow's Atmospheric, etc. Co.*, 5 C. B. 440; *German Bank v. Stumpf*, 6 Mo. App. 17; *Hasenritter v. Kirchhoffer*, 79 Mo. 239; *Whitney v. Robinson*, 53 Wisc. 309; 10 N. W. 512; *White Oak Grove Benev. Soc. v. Murray*, 145 Mo. 622; 47 S. W. 501. *Co.*, 10 R. I. 112; *Slocum v. Warren*, 10 R. I. 116; *Wheelock v. Kost*, 77 Ill. 296; *Tanner v. Nichols*, 80 S. W. 225; 25 Ky. Law Rep. 2191. See also *Casey v. Galli*, 94 U. S. 673; *Marwell v. Akin*, 89 Fed. 178.

² *Camp v. Byrne*, 41 Mo. 525. Cf. *Canfield v. Gregory*, 66 Conn. 9; 33 Atl. 536 (suit by receiver of supposed insolvent corporation to collect unpaid subscriptions).

³ *Slocum v. Providence Steam, etc.* Cf. *Keen v. Whittington*, 40 Md. 489, 495.

property to a supposed corporation may be taken as representing to any person to whom the supposed corporation may convey the land that the company is duly incorporated, and accordingly may be estopped from asserting the contrary as a flaw in the title of such grantee.¹

§ 281. **Estoppel of supposed Corporation to deny its own Existence.** — Perhaps without any real extension of this principle the estoppel might be held to cover the shareholders collectively, that is, the supposed corporation. That is to say, when persons have held themselves out to the world as members of a corporation, they might be held to be estopped from denying that fact when strangers take them at their word and sue them as a corporation. To this effect are many American cases.² The objection to this view is that the capacity to be sued as a corporation is in a sense jurisdictional, so that to permit an action against an association as if it were a corporation because of a mere equity against its members is very like estopping the court. Consequently, one cannot well find fault with a decision that an action cannot be sustained against an unincorporated association merely because of an equitable estoppel of its members to deny the incorporation.³ Upon the same principle, an English judge held that the question whether a certain association was a corporation and so within the statutes conferring jurisdiction for the winding-up of companies had to be decided without reference to any estoppel of the members to deny their corporate existence.⁴ Nevertheless, the prevalent American doctrine

¹ *Snyder v. Studebaker*, 19 Ind. 462; 81 Am. Dec. 415. See also *infra*, p. 238, n. 1. Cf. § 294.

² E. g. *Callender v. Painesville, etc. R. R. Co.*, 11 Ohio St. 516; *McCullough v. Talledega Ins. Co.*, 46 Ala. 376, 377; *Stewart Paper Mfg. Co. v. Rau*, 92 Ga. 511; 17 S. E. 748.

Of course, no such estoppel can bind a *de jure* corporation subsequently formed; *Bradley Fertilizer Co. v. South Publishing Co.*, 4 N. Y. Misc. 172; 23 N. Y. Supp. 675.

³ *Boyce v. Towsontown Sta. M. E. Church*, 46 Md. 359.

⁴ *National Debenture and Assets Corp.* (1891), 2 Ch. 505, 509–510

(headnote inadequate). Said Kekewich, J., "It is said in short, that the company is estopped from setting up this case as an objection. I do not think it is necessary to deal with the question of estoppel. The point has been mentioned to the court. The court has to make the order, and will not knowingly make an order which is wrong in form and substance in a matter of this kind, however much the parties may be estopped from bringing forward any argument against it. I say 'in a matter of this kind,' because the question is one of jurisdiction. . . . On a question of jurisdiction, I take

supported by the cases cited above cannot be deemed any very flagrant violation of established principles of estoppel *in pais*.

§ 282. **Estoppel by Dealing with supposed Corporation.** — But many American courts — perhaps we should say, most American courts — go further and hold not only that those who participate in representing to the public that a defectively incorporated company of which they are members is a legally constituted corporation are estopped to deny its corporate character, but also that anybody who deals with them as a corporation is likewise estopped.¹ That is to say, any one who contracts with a company which is purporting to act as a corporation cannot subsequently when sued upon the contract by the supposed corporation deny the company's corporate existence, nor can he hold the members of the supposed corporation as partners.

This conclusion, it is submitted, cannot be justified by the ordinary principles of estoppel *in pais*. For the person or persons

it, the court must make up its own mind and is bound to disregard any question of estoppel."

¹ *Casey v. Galli*, 94 U. S. 673, 680 (semble); *Close v. Glenwood Cemetery*, 107 U. S. 466, 476-477; 2 Sup. Ct. 267; *Studebaker Bros. Mfg. Co. v. Montgomery*, 74 Mo. 101; *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123; 28 S. W. 668; 26 L. R. A. 509; 45 Am. St. Rep. 700; *Estey Mfg. Co. v. Runnels*, 55 Mich. 130; 20 N. W. 823; *Stoutimore v. Clark*, 70 Mo. 471 (estoppel raised by signing note payable to "Missouri City Savings Bank"); *Worcester Med. Institution v. Harding*, 11 Cush. 285; *Seaton v. Grimm*, 110 Iowa 145; 81 N. W. 225 (where the party estopped was himself a corporator); *Planters', etc. Bank v. Padgett*, 69 Ga. 159; *Thompson v. Commercial, etc. Ass. Co.*, 78 Pac. 1073 (Colo.); *Rannels v. Rowe*, 145 Fed. 296; 74 C. C. A. 376; *Whitney v. Robinson*, 53 Wisc. 309; 10 N. W. 512; *Platte Valley Bank v. Harding*, 1 Nebr. 461 (estoppel raised by signing note payable to "Platte Valley Bank or order"); *Hasselman v. U. S. Mtg. Co.*, 97 Ind. 365 (person claiming title to land

under a supposed corporation estopped to deny its existence for the purpose of avoiding a prior mortgage executed by it upon the property); *Gow v. Collin, etc. Lumber Co.*, 109 Mich. 45; 66 N. W. 676; *Western Investment Co. v. Davis* (Ind. Ty.), 104 S. W. 573; *Young v. Plattner Implement Co.* (Colo.), 91 Pac. 1109 (estoppel by execution of a note reciting the payee to be a corporation); *Lincoln Park Chapter v. Swatek*, 204 Ill. 228; 68 N. E. 429 (estoppel by receiving dividends); *Brooke v. Day* (Ga.), 59 S. E. 769, 770 (semble); *Union Pac. Lodge v. Bankers' Surety Co.* (Nebr.), 113 N. W. 263.

Cf. *Black River, etc. R. R. Co. v. Clarke*, 25 N. Y. 208; *West Winsted Sav. Bank v. Ford*, 27 Conn. 282; 71 Am. Dec. 66.

In *Marion Savings Bank v. Dunkin*, 54 Ala. 471 (where the doctrine stated in the text, although recognized as law, was held to be inapplicable because the person against whom the estoppel was invoked had had no direct dealings with the supposed corporation).

in whose favor the estoppel is invoked — that is, the supposed corporation or its members — were not misled by any misrepresentation of the person who is to be estopped. If we assume that whoever deals with a company which claims to be a corporation impliedly represents to it that it is incorporated, yet the supposed company or its members are not misled; for they are better acquainted with the facts than he can possibly be.¹ If the argument be advanced that he impliedly represents that he will not when sued upon the contract deny the company's corporate existence, the answer is that a promissory representation cannot give rise to an estoppel.² Moreover, the contrary view permits persons by arrogating corporate functions to themselves in entire defiance of law, and in complete disregard of salutary legal restrictions, to create, virtually, a corporation which will have such powers as their own whim from time to time may dictate and whose existence will be as real for all practical purposes as if it were legally organized.

Hence, those cases are to be commended which protest against the perversion of the sound doctrine of estoppel to deny corporate existence into this very different doctrine of "corporations by estoppel."³ This protest is reinforced by a line of cases holding that "corporations by estoppel" exist only when the facts are such as, according to the principles adverted to in a succeeding paragraph, would constitute the association a "*de facto* corporation."⁴ In so far as these latter cases assimilate or confuse

¹ If the supposed corporation assigns to a third person property which has been granted to it as a corporation, the original grantor may well be estopped from denying the title of the purchaser from the supposed corporation. See *Green v. Grigg*, 98 N. Y. App. Div. 445; 90 N. Y. Supp. 565, and *supra*, § 280.

² Bigelow on Estoppel, 5th ed., p. 574.

³ *Boyce v. Towson Town Station M. E. Church*, 46 Md. 359; *Welland Canal Co. v. Hathaway*, 8 Wend. 480, 483-484; 24 Am. Dec. 51 (substantially overruled by *Black River, etc. R. R. Co. v. Clarke*, 25 N. Y. 208); *Williams v. Hewitt*, 47 La.

Ann. 1076; 17 So. 496; 49 Am. St. Rep. 394; *Abbott v. Omaha Smelting Co.*, 4 Nebr. 416; *Griffin v. Clinton Line, etc. R. R. Co.*, 11 Fed. Cas. 27; *Provident, etc. Trust Co. v. Saxon*, 116 La. 408; 40 So. 778; *Louisiana Nat. Bank v. Henderson*, 116 La. 413; 40 So. 779.

Cf. *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593; 54 N. E. 407; 72 Am. St. Rep. 326; *Doyle v. Mizner*, 42 Mich. 332; 3 N. W. 968; *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143; *Glenn v. Bergman*, 20 Mo. App. 343.

⁴ *Jones v. Aspen Hardware Co.*, 21 Colo. 263, 268; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143;

the doctrines of estoppel and of *de facto* corporations, it is submitted that they are to be regretted; but in so far as they impliedly repudiate the notion of "corporations by estoppel," they may be heartily approved.

Where the doctrine of corporations by estoppel is recognized, in an action against the members of the supposed corporation as partners, the plaintiff, in order to negative any estoppel, may show that at the time of dealing with the alleged corporation he was informed that the company was a partnership.¹

§ 283. **Disproof of Incorporation.** — To disprove incorporation, the most satisfactory evidence is the testimony of the lawful custodian of the register of corporations to the effect that no incorporation paper has ever been recorded on behalf of the supposed company.² In Texas, it has been held that the testimony of a private person to the effect that he had examined the register of corporations and failed to find any record of a corporation bearing a certain name is not admissible;³ but it is submitted that according to the better view any person who has examined the records may testify as to what is not to be found there.⁴ A certificate from the custodian of the record that the supposed incorporation paper had *not* been filed is not evidence.⁵ It has been held, however, that if the original incorporation paper is produced, the fact that it bears no indorsement indicative of having been filed with the proper officer is evidence that it was not so filed.⁶

Evidence that residents of the supposed domicile of the alleged corporation had never heard of its existence has been said to be competent.⁷

Stanwood v. Sterling Metal Co., 107 Ill. App. 569, 574. Cf. *infra*, § 291.

¹ *Christian, etc. Grocery Co. v. Fruitdale Lumber Co.*, 25 So. 566; 121 Ala. 340.

² *Cobb v. Bryan* (Tex.), 83 S. W. 887 (semble).

³ *Cobb v. Bryan* (Tex.), 83 S. W. 887.

⁴ *Cross v. Pinckneyville Mill Co.*, 17 Ill. 54, 55 (semble).

⁵ *Cross v. Pinckneyville Mill Co.*, 17 Ill. 54; *Lusk v. Riggs*, 97 N. W. 1033, 1034; 70 Nebr. 713 (semble).

⁶ *Lusk v. Riggs*, 97 N. W. 1033 (headnote inadequate); 70 Nebr. 713.

⁷ *Cobb v. Bryan* (Tex.), 83 S. W. 887 (semble).

We have seen above that in attacking collaterally the existence of an alleged corporation, it is not permissible to show that a public officer's certificate of due incorporation that may be required by law was obtained by the fraud of the promoters.¹ Similarly, it is not competent in a collateral proceeding to show that some of the material statements in the incorporation paper are false in point of fact,² or that some of the subscribers who on the face of the paper appear to have duly acknowledged it did not in fact do so.³ *A fortiori*, it is not a good plea to an action by the company that the execution of the incorporation paper, or deed of settlement, was obtained by fraud without alleging upon whom the fraud was practised.⁴ On the other hand, these doctrines will not be allowed to shield promoters who may have been guilty of fraud;⁵ and the courts will rip open the incorporation in so far as may be necessary to restore defrauded parties to the *status in quo* and in so far as can be done without risk of injustice to innocent persons who have had dealings with the corporation.⁶ Moreover, in cases of fraud, it would seem that in America judgment of ouster might be entered against the corporation at the instance of the state.⁷

¹ Supra, § 267.

² *Buffalo, etc. R. R. Co. v. Hatch*, 20 N. Y. 157, 159 (headnote inadequate); *Am. Salt Co. v. Heidenheimer*, 80 Tex. 344; 15 S. W. 1038; 26 Am. St. Rep. 743.

But see *Montgomery v. Forbes*, 148 Mass. 249 (incorporation without *bona fide* intent to carry on business at place named in incorporation paper). That false statements in an incorporation paper will not sustain an action of deceit against the subscribers, see *Webb v. Rockefeller*, 195 Mo. 57, 63-75; 93 S. W. 772.

³ *First Nat. Bank v. Rockefeller*, 195 Mo. 15 (headnote misleading); 93 S. W. 761.

As to the conclusiveness of the magistrate's certificate of acknowledgment, see *Dooley v. Cheshire*

Glass Co., 15 Gray (Mass.) 494 (headnote inadequate).

As to a case where some of the signatures to the instrument are forgeries, see supra, p. 229, n. 3.

⁴ *Pilbrow v. Pilbrow's Atmospheric, etc. Co.*, 5 C. B. 440.

⁵ *Montgomery v. Forbes*, 148 Mass. 249; 19 N. E. 342; *Patterson v. Arnold*, 45 Pa. St. 410 (overruled in *Cochran v. Arnold*, 58 Pa. St. 399); *Niemeyer v. Little Rock Junction Ry.*, 43 Ark. 111. And see infra, § 287.

⁶ *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765; 75 C. C. A. 631.

⁷ Cf. *Holman v. State ex rel. Gibson*, 105 Ind. 569; 5 N. E. 702; *State ex inf. Attorney-General v. Hogan*, 163 Mo. 43; 63 S. W. 378; *Webb v. Rockefeller*, 195 Mo. 57; 93 S. W. 772.

§ 284-§ 292. INCORPORATION DE FACTO.

§ 284. **Whether irregular Incorporation Proceedings can give rise to Corporation De Facto.** — Cases not seldom arise in which some condition precedent to the legal organization of a corporation has been omitted, and in which no conclusive certificate of due incorporation exists, and in which no estoppel to deny the company's existence can be invoked. In such cases, the American courts generally will, under certain conditions, hold that the association although not legally incorporated is nevertheless a corporation *de facto*, that is to say, an association whose right to corporate functions and attributes is complete as against all the world except the sovereign.¹ This doctrine, which is based upon analogy to the law of *de facto* officers,² has never received recognition in England,³ and is apparently repudiated in Maryland.⁴ So too, in some other states, the rule has been enunciated that the non-performance of any material require-

¹ *Commissioners of Douglas County v. Bolles*, 94 U. S. 104; *Doty v. Patterson*, 155 Ind. 60; 56 N. E. 668; *Stout v. Zulick*, 48 N. J. Law, 599; 7 Atl. 362; *Tulare Irrigation District v. Shepard*, 185 U. S. 1; 22 Sup. Ct. 531; *Leavengood v. McGee* (Oreg.), 91 Pac. 453; *Gilkey v. Town of How*, 105 Wisc. 41 (a *de facto* municipal corporation); *New Orleans Debenture, etc. Co. v. La.*, 180 U. S. 320, 327-328; 21 Sup. Ct. 378; *Baltimore, etc. R. R. Co. v. Fifth Baptist Church*, 137 U. S. 568; 11 Sup. Ct. 185; *Eaton v. Aspinwall*, 19 N. Y. 119; *Venable v. Ebenezer Baptist Church*, 25 Kans. 177.

² Note, however, that the doctrine of *de facto* corporations applies in favor of the supposed corporation itself, whereas the doctrine of *de facto* officers does not apply in favor of the officer himself. A reason for this distinction may be found in the fact that the *de facto* corporation is composed of natural persons who may be regarded as innocent third persons, so that when the *de facto* doctrine is applied nominally in favor of the corporation itself it is substantially applied in favor of innocent shareholders.

³ See, for example, *National Debenture, etc., Corp.* (1891), 2 Ch. 505, and *Laxon & Co.* (1892), 3 Ch. 555, and other cases cited supra, § 268, where neither counsel nor court dreamt of attempting to apply any such doctrine as the American doctrine of *de facto* corporations.

As to Canadian law, see *Common v. McArthur*, 29 Can. Sup. Ct. 239 (where the principle of *de facto* incorporation seems to have been acted upon).

⁴ *Boyce v. Townsontown Station M. E. Church*, 46 Md. 359; *Maryland Tube Works v. West End Imp. Co.*, 87 Md. 207; 39 Atl. 620; 39 L. R. A. 810.

Cf. *Workingmen's Accommodation Bank v. Converse*, 29 La. Ann. 369. But as to the Maryland law, see *Keene v. Van Reuth*, 48 Md. 184 (which as to the actual decision can be explained on the ground mentioned supra, § 278, and also relied upon by the court).

ment of an incorporation law will always render the attempted incorporation void except where an estoppel to enter upon the question can be raised.¹ But according to the decided weight of American authority the possibility of *de facto* corporations is recognized.

As an original question, it is very difficult to sustain this prevalent American doctrine. We have seen that a company becomes incorporated *de jure* when the only irregularity consists in a failure to observe directory provisions of the incorporation laws,² or where the law has been substantially complied with.³ Moreover, irregularities in the incorporation proceedings are not to be presumed; and we have seen above that where no irregularities in the incorporation proceedings affirmatively appear, very slight evidence will be sufficient proof of incorporation.⁴ Furthermore, breaches of conditions subsequent to incorporation can never be availed of by persons other than the state, unless the legislature in express words so directs.⁵ In some cases, also, an estoppel may prevent the question from being raised.⁶ It is only when all these principles fail, that the American doctrine of *de facto* corporations becomes operative. When this is the case, — when there has been a failure to perform some act, performance of which the legislature has declared to be a condition precedent to incorporation, when this fact affirmatively appears in evidence, and when no party is estopped to allege the truth, upon what principle are the courts justified in holding that although the legislature has declared there shall not be a corporation yet there shall be a corporation except as against the sovereign? If it were common law that private persons might without statutory or royal authority by mere agreement convert themselves into a corporation which should have

¹ Said the court in *Slocum v. Providence, etc. Steam Co.*, 10 R. I. 112, 114: "We know of no rule which precludes inquiry into the question, whether a company which assumes to act as a corporation has ever been incorporated, in any case, in the absence of any matter of estoppel to prevent the inquiry."

Cf. *Kaiser v. Lawrence Savings Bank*, 56 Iowa 104; 8 N. W. 772; 41 Am. Rep. 85; *Doyle v. Mizner*,

42 Mich. 332; 3 N. W. 968; *Griffin v. Clinton Line, etc. R. R. Co.*, 11 Fed. Cas. 27; *Hurt v. Salisbury*, 55 Mo. 310; *Indianapolis, etc. Co. v. Herkimer*, 46 Ind. 142; *Williams v. Hewitt*, 47 La. Ann. 1076; 17 So. 496; 49 Am. St. Rep. 394.

² *Supra*, § 264.

³ *Ibid.*

⁴ § 274.

⁵ § 265.

⁶ § 278—§ 282.

all the characteristics of a lawful corporation except where the state is concerned, then the American doctrine of *de facto* corporations might be sustained, on the ground that such incorporations owe their existence to the common law rather than to an incorporation statute which has not been complied with. But as far back as the time of Edward III, the common law was settled adversely to this hypothesis.¹ The only ground on which the American doctrine of *de facto* corporations can well be sustained is that the legislature in prescribing certain conditions precedent to incorporation must be taken to have intended them to be conditions precedent to incorporation *de jure* merely, and not necessarily (in cases where colorable compliance with law is had) to incorporation as regards private persons.²

§ 285-§ 290. *Circumstances necessary to create a Corporation De Facto.*

§ 285. **In general.** — Even under the prevalent American doctrine of *de facto* corporations, certain circumstances must concur in order to warrant its application. If there be a valid statute under which a company might be incorporated, a *bona fide* colorable attempt to comply with the law, and finally an organization and exercise of corporate functions, all the authorities which recognize the doctrine of *de facto* corporations would, probably, agree that a proper case has been made for holding that the company is a *de facto* if not a *de jure* corporation.³

§ 286. **Requirement of a Law under which the Corporation might be formed.** — The existence of a law under which the corporation might lawfully be organized is recognized by the weight of authority as a necessary condition to the attainment of a *de facto* corporate existence.⁴ Some cases hold that the ex-

¹ Y. B. 49 Edw. III, 3. See also, *St. Rep.* 552; *Doty v. Patterson*, 155 Ind. 60; 56 N. E. 668; *Tulare Irrigation District v. Shepard*, 185 U. S. 1; 22 Sup. Ct. 531; *Stout v. Zulick*, 48 N. J. Law 599; 7 Atl. 362.

² This rule of statutory construction — for such it really is — has been expressly enacted as law in California. ³ *Am. Loan & Trust Co. v. Minnesota, etc. R. R. Co.*, 157 Ill. 641; 42 N. E. 153; *Gillette v. Aurora Ry. Co.*, 81 N. E. 1005; 228 Ill. 261.

⁴ *Finnegan v. Noerenburg*, 52 Minn. 239; 53 N. W. 1150; 38 Am. Cf. *Snyder v. Studebaker*, 19 Ind.

istence of an unconstitutional statute or enabling act satisfies this requirement;¹ but a larger number take the opposite view.² Some authorities insist that if all the objects of the supposed corporation are objects for which the statute does not authorize companies to be incorporated, the case is as if no incorporation act were on the statute books.³ Moreover, some authorities maintain that if persons who are not under the statute competent to act as incorporators attempt to form a corporation, there is no law under which they might be incorporated so that no *de facto* corporation can result from the attempt.⁴

§ 287. **Requirement of Bona Fides in attempting to comply with Law.**—The requirement that in order to give rise to a

462 (proceeding on the ground of estoppel and declaring that an estoppel cannot be raised on a matter of law); *St. Louis Colonization Ass'n v. Hennessy*, 11 Mo. App. 555, 556 (semble—similar point to that of last case).

¹ *Board of Comm'rs v. Shields*, 62 Mo. 247; *Coxe v. State*, 144 N. Y. 396, 409; 39 N. E. 400; *Hudson v. Green Hill Cemetery*, 113 Ill. 618; *Catholic Church v. Tobbein*, 82 Mo. 418; *Lang v. Mayor, etc. of Bayonne* (N. J.), 68 Atl. 90.

Cf. *Smith v. Sheeley*, 12 Wall. 358 (holding that an association organized under an act of a territorial legislature which could not take effect until approved by Congress was nevertheless a corporation *de facto*).

² *Brandenstein v. Hoke*, 101 Cal. 131; 35 Pac. 562; *Eaton v. Walker*, 76 Mich. 579; 43 N. W. 638; 6 L. R. A. 102.

Cf. *Georgia Southern, etc. R. R. Co. v. Mercantile Trust Co.*, 94 Ga. 306; 21 S. E. 701; 47 Am. St. Rep. 153; 32 L. R. A. 208 (attempt to incorporate under an unconstitutional special act held to create a corporation *de facto* because of the existence of a valid general law under which the company might have been organized); *Snyder v. Studebaker*, 19 Ind. 462; 81 Am. Dec. 415 (over-

ruling *Evansville, etc. R. R. Co. v. City of Evansville*, 15 Ind. 395 and also holding, notwithstanding *Hariman v. Southam*, 16 Ind. 190, that it is sufficient if a valid special act of incorporation was at one time in existence although repealed by a new constitution before it was accepted).

³ *Davis v. Stevens*, 104 Fed. 235; *Vredenburg v. Behan*, 33 La. Ann. 627, 635–636; *Indiana Bond Co. v. Ogle*, 22 Ind. App. 593; 54 N. E. 407; 72 Am. St. Rep. 326; *Gillette v. Aurora Ry. Co.*, 81 N. E. 1005; 228 Ill. 261.

But cf. *Lancaster v. Amsterdam Imp. Co.*, 140 N. Y. 576, 584 (head-note inadequate); 35 N. E. 964; 24 L. R. A. 322; *Williams v. Citizens' Ry. Co.*, 130 Ind. 71, 73–75; 29 N. E. 408; 30 Am. St. Rep. 201; 15 L. R. A. 64; *Gaff v. Flesher*, 33 Oh. St. 107, 113–115, 453.

See also *infra*, § 296.

⁴ Cf. *Evenson v. Ellingson*, 67 Wisc. 634; 31 N. W. 342 (unauthorized union of two churches to form one corporation, whereas the statute allowed incorporation of any single church or religious society).

But see *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 506–511; 36 C. C. A. 155.

corporation *de facto* the attempt to comply with the incorporation law must not merely be colorable but must also be *bona fide* is, at least apparently, insisted upon by some authorities. The difficulty in applying this rule is that although the original promoters and incorporators may not have acted in good faith, those who subsequently acquire shares in the company, or have dealings of any kind with it, may be quite innocent. In case of a fraudulent but colorable attempt to secure the benefits of incorporation, the courts should frustrate the effort, and may perhaps hold the fraudulent parties subject to any liability which they would have incurred if the company were unincorporated,¹ but so far as innocent third persons — such as innocent shareholders or creditors — are concerned, the company should certainly be treated as a *de facto* corporation.² Thus, we have seen that it is not permissible to attack incorporation collaterally by showing that some of the statements in the incorporation paper are untrue,³ or that a certificate of due incorporation was obtained by fraud.⁴ It should be added that fraud in this connection does not mean an intent to use the corporation for dishonest purposes but rather means an attempt to secure the benefits of incorporation without complying, except colorably, with its provisions. Fraud on the law is meant rather than a fraud on individuals, although of course the two kinds of fraud may overlap.

¹ *Gartside Coal Co. v. Maxwell*, 22 Fed. 197 (semble); *Montgomery v. Forbes*, 148 Mass. 249; 19 N. E. 342; *Patterson v. Arnold*, 45 Pa. St. 410 (overruled in *Cochran v. Arnold*, 58 Pa. St. 399); *Christian, etc. Grocery Co. v. Fruitdale Lumber Co.*, 121 Ala. 340, 345-346; 25 So. 566; *Brundred v. Rice*, 49 Oh. St. 640; 32 N. E. 169; 34 Am. St. Rep. 589.

Cf. *Jones v. Missouri Edison Electric Co.*, 144 Fed. 765; 75 C. C. A. 631; *Davidson v. Hobson*, 59 Mo. App. 130; *Niemeyer v. Little Rock Junction Ry.*, 43 Ark. 111; *Farnham v. Benedict*, 107 N. Y. 159; 13 N. E. 784; *Jersey City Gas Co. v. Dwight*, 29 N. J. Eq. 242 (which, in *Elizabethtown Gas Light Co. v. Green*, 46 N. J. Eq. 118, 130, affirmed on opinion below, 49 N. J. Eq. 329,

was declared to have been overruled by *National Docks Ry. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755); *Southern Bank v. Williams*, 25 Ga. 534.

² *Patterson v. Arnold*, 45 Pa. St. 410, 415-416 (semble); *Duggan v. Colorado Mtg., etc. Co.*, 11 Colo. 113, 117 (headnote inadequate — where one of the signatures to incorporation paper was a forgery); *National Docks Ry. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755 (headnote inadequate); *Attorney-General v. Stevens*, Saxt. Ch. (1 N. J. Eq.) 369; *Aurora, etc. R. R. Co. v. City of Lawrenceburgh*, 56 Ind. 80, 87; *Terhune v. Midland R. R. Co.*, 38 N. J. Eq. 423.

See *infra*, § 299. Cf. *Booth v. Wonderly*, 36 N. J. Eq. 250.

³ *Supra*, § 283.

⁴ *Supra*, § 267.

§ 288. **Requirement of Substantial or Colorable Compliance with Law.** — In some cases, it has been said that only where the incorporation law has been substantially complied with can the company be a *de facto* corporation;¹ but if this be true the whole efficacy is extracted from the doctrine of *de facto* corporations. For in any case of *substantial* compliance with law, the company is incorporated *de jure*² and not merely *de facto*. Colorable compliance with the incorporation law is essential in order to create a corporation *de facto*;³ but substantial compliance is not necessary.⁴

§ 289. **What amounts to Colorable Compliance.** — In determining what amounts to colorable compliance with the incorporation law, much is necessarily left to the discretion, one might almost say the disposition, of the judge. The true test of colorable compliance is this: has the incorporation law been so far complied with that although some condition precedent to incorporation prescribed by the legislature has not been observed, yet the courts are justified in inferring or assuming that the legislature meant that the irregularity in question should have no more serious effect than a breach of a condition precedent to incorporation *de jure* but not precedent to incorporation *de facto*?

The defects in the incorporation paper, and in and about its execution and registration, which are deemed so serious that there cannot be deemed to be even colorable compliance with the law have been already pointed out in a previous chapter.⁵

¹ *Kaiser v. Lawrence Savings Bank*, 56 Iowa 104, 109; 8 N. W. 772; 41 Am. Rep. 85; *Harris v. McGregor*, 29 Cal. 124; *Williams v. Hewitt*, 47 La. Ann. 1076; 17 So. 496; 49 Am. St. Rep. 394; *Cresswell v. Oberly*, 17 Ill. App. 281, 283. Am. St. Rep. 85; *Card v. Moore*, 68 N. Y. App. Div. 327, 337; 74 N. Y. Supp. 18, affirmed short, 173 N. Y. 598; 66 N. E. 1105; *Booth v. Wonderly*, 36 N. J. Law 250.

Cf. *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143.

² *Supra*, § 264.

³ *McLennan v. Hopkins*, 2 Kans. App. 260; 41 Pac. 1061; *Lusk v. Riggs*, 97 N. W. 1033; 70 Nebr. 713; *Abbott v. Omaha Smelting Co.*, 4 Nebr. 416; *Bergeron v. Hobbs*, 96 Wisc. 641; 71 N. W. 1056; 65

Cf. *Bradley Fertilizer Co. v. South Publishing Co.*, 4 N. Y. Misc. 172; 23 N. Y. Supp. 675.

⁴ *Finnegan v. Noerenberg*, 52 Minn. 239; 53 N. W. 1150; 38 Am. St. Rep. 552; *Johnson v. Okerstrom*, 70 Minn. 303; 73 N. W. 147.

Cf. *Georgia Southern, etc. R. R. Co. v. Mercantile Trust Co.*, 94 Ga. 306; 21 S. E. 701; 47 Am. St. Rep. 153; 32 L. R. A. 208.

⁵ Chap. II, *passim*.

Of course, if no written incorporation paper is ever executed, there is no colorable compliance with the incorporation law and therefore no corporation *de facto*.¹ On the other hand, an incorporation paper which on its face complies with law will amount to colorable compliance with the statute although some of the statements in the instrument are false in point of fact.² There may be colorable compliance although the affidavit annexed to the incorporation paper omits the averment required by the statute of a *bona fide* intent to construct the railroad mentioned in the instrument.³

Where there is a distinct statutory prohibition against exercising any corporate privileges until a certain condition has been performed, it is very difficult to hold that there can be even colorable compliance with law without at least apparent performance of that condition.⁴ For example, where a statute prohibits the exercise of any corporate privileges before a certain tax is paid, there can be no colorable compliance with the incorporation law and therefore no corporation *de facto* unless the tax is paid.⁵

§ 290. **Requirement of User of Corporate Privileges.** — As to what is sufficient evidence of user of corporate privileges to constitute an association a corporation *de facto* ⁶ there is much diversity of opinion. As it is very difficult to point out any sharp visible distinction between a corporation and an unincorporated

¹ *Utley v. Union Tool Co.*, 11 Gray (Mass.) 139; *Bradley Fertilizer Co. v. South Publishing Co.*, 4 N. Y. Misc. 172; 23 N. Y. Supp. 675.

But cf. *Merrick v. Reynolds Engine, etc. Co.*, 101 Mass. 381.

² See *supra*, § 283.

³ *Buffalo, etc. R. R. Co. v. Cary*, 26 N. Y. 75.

⁴ In addition to cases cited below, compare *Workingmen's Accommodation Bank v. Converse*, 29 La. Ann. 369.

⁵ *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143; *Maryland Tube Works v. West End Improvement Co.*, 87 Md. 207; 39 Atl. 620; 39 L. R. A. 810 (with

which should be compared the decisions in the same state apparently repudiating the whole doctrine of *de facto* corporations, *supra*, § 284).

⁶ In addition to cases cited below, see *Finnegan v. Noerenberg*, 52 Minn. 239; 53 N. W. 1150; 38 Am. St. Rep. 552 (where evidence of user was held sufficient); *Johnson v. Okerstrom*, 70 Minn. 303; 73 N. W. 147 (as to the permissible methods of proving user); *Martin v. Deetz*, 102 Cal. 55; 36 Pac. 368; 41 Am. St. Rep. 151 (where the proof was held insufficient); *Stanwood v. Sterling Metal Co.*, 107 Ill. App. 569 (evidence of user held insufficient); *DeWitt v. Hastings*, 69 N. Y. 518 (evidence of user held insufficient).

body, this diversity of opinion is natural. Probably, the best rule is that in each case it is a question of fact whether the associates have acted under a public claim of incorporation. The use of a name appropriate to a corporation even though not necessarily peculiar to a corporation, the use of a corporate seal, the election of directors or officers,¹ are circumstances tending to establish this public claim even though not conclusive upon the point. General reputation has been held to be evidence of user of corporate privileges.²

§ 291-§ 292. *Nature of De Facto Corporations.*

§ 291. **De Facto Corporations Distinguished from Corporations by Estoppel.** — The doctrine of *de facto* corporations is often confused with the principle of estoppel. We have seen that some courts assert that no one can be estopped to deny the incorporation of a company unless the elements of a corporation *de facto* are present.³ Many other cases treat the doctrine of *de facto* corporations as resting on the ground of estoppel,⁴ or are so meagre or indistinct that nobody can say whether they are based on the ground of estoppel or on the ground that the company is a corporation *de facto*, or on both grounds.⁵ But in reality the two principles are quite distinct. The doctrine of *de facto* corporations does not rest on estoppel, but on that public policy which is thought to prohibit the annulling of a company's acts because of some technical flaw in the incorporation proceedings, which, perhaps, none but a skilled lawyer

¹ *Buffalo, etc. R. R. Co. v. Cary*, 26 N. Y. 75; *Johnson v. Okerstrom*, 70 Minn. 303; 73 N. W. 147.

² *Holmes v. Gilliland*, 41 Barb. (N. Y.) 568.

³ *Supra*, § 282. And see *Guckert v. Hacke*, 159 Pa. St. 303; 28 Atl. 249 (semble).

⁴ E. g. *Smith v. Sheeley*, 12 Wall. 358; *Sniders' Sons v. Troy*, 91 Ala. 224; 8 So. 658; 11 L. R. A. 515; 24 Am. St. Rep. 887.

⁵ *Andes v. Ely*, 158 U. S. 312; 15 Sup. Ct. 954; *County of Leavenworth v. Barnes*, 94 U. S. 70 (head-note misleading); *Chubb v. Upton*,

95 U. S. 665; *Commercial Bank v. Pfeiffer*, 108 N. Y. 242; 15 N. E. 311; *Baker v. Neff*, 73 Ind. 68; *Hagerman v. Ohio Bldg., etc. Ass'n*, 25 Ohio St. 186; *Butchers', etc. Bank*, 130 Mass. 264; *Curtis v. Meeker*, 62 Ill. App. 49; *Ramsey v. Peoria, etc. Ins. Co.*, 55 Ill. 311; *Old Colony Trust Co. v. City of Wichita*, 123 Fed. 762, 776; *Empire Mfg. Co. v. Stuart*, 46 Mich. 482; 9 N. W. 527; *Fitzpatrick v. Rutter*, 160 Ill. 282; 43 N. E. 392; *Hause v. Mannheimer*, 67 Minn. 194; 69 N. W. 810; *Marsh v. Mathias*, 19 Utah 350; 56 Pac. 1074.

could detect.¹ Hence, according to the doctrine of incorporation *de facto*, the company's existence, although *de facto* only, is real as against all the world,² even against persons who have had no dealings with it and who, therefore, could not on any theory be estopped.³

§ 292. **Powers, Rights, etc., of Corporation De Facto.** — Wherever the *de facto* doctrine is applied, the attainment of a *de facto* corporate existence is tantamount, to all intents and purposes, to the creation of a corporation which may at any moment suffer corporate capital punishment and which is in all respects in the same condition as a company whose original incorporation was regular but which has forfeited the right to existence by reason of misconduct or breach of a condition subsequent. Thus, a *de facto* company possesses all the powers of mortgaging after-acquired property, consolidating with other companies, and the like, which a *de jure* corporation of the same class might enjoy,⁴ the only possible exception⁵ — and that although supported by some authorities⁶ yet denied by a still greater number⁷ — being in regard to powers in derogation of common right, such as the power to condemn private property.

¹ *Society Perun v. Cleveland*, 43 Oh. St. 481; 3 N. E. 357; *Buffalo, etc. R. R. Co. v. Cary*, 26 N. Y. 75.

² Cf. *Bushnell v. Consolidated Ice Machine Co.*, 138 Ill. 67; 27 N. E. 596 (holding that shareholder in corporation *de facto* cannot maintain bill for partnership accounting against his fellow-members).

³ *Haas v. Bank of Commerce*, 41 Nebr. 754; 60 N. W. 85; *Williamson v. Kokomo Bldg., etc. Ass'n*, 89 Ind. 389; *Doty v. Patterson*, 155 Ind. 60; 56 N. E. 668 (semble); *East Norway Church v. Froislie*, 37 Minn. 447; 35 N. W. 260; *Chiniquy v. Bishop of Chicago*, 41 Ill. 148.

⁴ *Georgia Southern, etc. R. R. Co. v. Mercantile Trust, etc. Co.*, 94 Ga. 306; 32 L. R. A. 208; 21 S. E. 701; 47 Am. St. Rep. 153 (mortgaging after-acquired property); *People v. La Rue*, 67 Cal. 526 (consolidating with other companies).

⁵ But see *Gastonia Cotton Mfg. Co. v. W. L. Wells Co.*, 128 Fed. 369; 63 C. C. A. 111 (holding that for purposes of determining the jurisdiction of a federal court a corporation *de facto* cannot be treated as a citizen of the state under whose laws it attempted to organize), reversed on another point, *W. L. Wells Co. v. Gastonia Cotton Mfg. Co.*, 198 U. S. 177; 25 Sup. Ct. 640.

⁶ *Cumberland Telephone, etc. Co. v. St. Louis, etc. Ry. Co.*, 41 So. 492; 117 La. 199; *New York Cable Co. v. New York*, 104 N. Y. 1; 10 N. E. 332; *Orrick School Dist. v. Dorton*, 125 Mo. 439; 28 S. W. 765 (admission by property owner of corporate existence not sufficient); *Hampton v. Clinton Co.*, 65 N. J. Law 158.

⁷ *Ward v. Minnesota, etc. R. R. Co.*, 119 Ill. 287, 291-292; 10 N. E. 365; *Eddleman v. Union County Traction, etc. Co.*, 217 Ill. 409, 75

So, a court of equity will not refuse the extraordinary remedy of injunction because the plaintiff is a *de facto* corporation.¹ Moreover, the shareholders in a *de facto* corporation are subject to the same liabilities to creditors and other persons as if the incorporation had been *de jure*.² The existence of a *de facto* corporation is real even against the state³ except upon direct proceedings to oust it from corporate powers. Under a statute punishing criminally embezzlement from an "incorporated company" a conviction may be sustained if the company is a corporation *de facto*.⁴ Conversely, a statute applicable to "unincorporated companies" does not apply to companies which are corporations *de facto*.⁵ A corporation *de facto* cannot be wound-up as a partnership.⁶

N. E. 510; *National Docks Ry. Co. v. Central R. R. Co.*, 32 N. J. Eq. 755; *Gillette v. Aurora Ry. Co.*, 81 N. E. 1005; 228 Ill. 261 (semble — drawing a distinction between a denial of the company's corporate existence and a denial that even *de jure* corporations of the class to which this company belongs are authorized by law to condemn property); *Central of Ga. Ry. Co. v. Union Springs, etc. Ry. Co.*, 39 So. 473; 144 Ala. 639; *Morrison v. Forman*, 177 Ill. 427; 53 N. E. 73; *Smith v. Cleveland, etc. Ry. Co.* (Ind.), 81 N. E. 501, 507; *Wellington etc. R. R. Co. v. Cashie, etc. Lumber Co.*, 114 N. Car. 690; 19 S. E. 646; *Morrison v. Indianapolis, etc. Ry. Co.* (Ind.), 79 N. E. 961; 2 Lewis on Eminent Domain, § 391.

Cf. *Boca, etc. R. R. Co. v. Sierra Valleys Ry. Co.* (Cal.), 84 Pac. 298, 303 (where a *de jure* corporation claimed, unsuccessfully, the right as a *de facto* corporation to condemn property for a railway which by its incorporation paper it had no power to construct).

¹ *Williams v. Citizens Street Ry.*, 130 Ind. 71; 29 N. E. 408; 30 Am. St. Rep. 201; 15 L. R. A. 64; *Cincinnati, etc. R. R. Co. v. Danville, etc. Ry. Co.*, 75 Ill. 113.

² *Eaton v. Aspinwall*, 19 N. Y. 119; *Perkins v. Hatch*, 4 Hun (N. Y.) 137; *Rowland v. Meader Furniture Co.*, 38 Oh. St. 269; *Hamilton v. Clarion, etc. R. R. Co.*, 144 Pa. St. 34; 23 Atl. 53; 13 L. R. A. 779; *Aspinwall v. Sacchi*, 57 N. Y. 331 (as to right of shareholder who has been subjected to a statutory liability to creditors to enforce contribution from other shareholders in the *de facto* corporation); *Harris v. Gateway Land Co.*, 128 Ala. 652; 29 So. 611.

Cf. *St. Joseph, etc. Ry. Co. v. Shambaugh*, 106 Mo. 557, 566. The same result may often be reached on the ground of estoppel. See *supra*, § 280.

³ *People v. La Rue*, 67 Cal. 526.

Cf. *Coxe v. State*, 144 N. Y. 396 (where the point, although necessarily involved, does not appear to have been argued or considered).

⁴ *People v. Carter*, 122 Mich. 668; 81 N. W. 924.

⁵ *Rowland v. Meader Furniture Co.*, 38 Oh. St. 269.

⁶ *Bushnell v. Consolidated Ice Machine Co.*, 138 Ill. 67. Cf. cases cited *infra*, p. 253, n. 3, and also *Merchants, etc. Line v. Waganer*, 71 Ala. 581.

Of course, the attainment of a *de jure*, and not merely a *de facto*, existence may be made a condition in a contract so that the contract will not be enforceable unless the company becomes incorporated *de jure*. According to some authorities, such a condition is implied in a subscription to shares in a company to be subsequently formed.¹

The dissolution of a *de facto* corporation whether by *scire facias*, or *quo warranto*, or otherwise, is governed by the same principles as the dissolution of a *de jure* corporation, and therefore is beyond the scope of the present work. A judgment of ouster because of non-performance of conditions precedent to incorporation does not relate back so as to defeat the rights of third parties which may have vested during the company's *de facto* existence.²

§ 293-§ 294. *Rights and Liabilities of Members of defectively incorporated Company.*

§ 293. **Liability to Third Persons.** — The members of a defectively incorporated company are, in many states and under most circumstances, protected from individual liability for debts and torts of the association by the doctrines of estoppel and of *de facto* corporations. But in jurisdictions where those doctrines are not recognized or in cases where for any reason they do not apply, the members should be held liable as partners both *ex contractu*³

¹ See *supra*, § 260. As to whether a vendor of shares warrants the company to be incorporated *de jure*, see *infra*, § 973.

² *Society Perun v. Cleveland*, 43 Oh. St. 481; 3 N. E. 357; *Rowland v. Meader Furniture Co.*, 38 Oh. St. 269.

Cf. *Thompson v. N. Y., etc. R. R. Co.*, 3 Sandf. Ch. (N. Y.) 625, 651; *Farnsworth v. Drake*, 11 Ind. 101.

³ *McLennan v. Hopkins*, 2 Kans. App. 260; 41 Pac. 1061; *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123, 146; 28 S. W. 668; 26 L. R. A. 509; 45 Am. St. Rep. 700; *Williams v. Hewitt*, 47 La. Ann. 1076; 17 So. 496; 49 Am. St. Rep. 394; *Davis v. Stevens*, 104 Fed. 235;

Wechselberg v. Flour City Nat. Bank, 64 Fed. 90; 12 C. C. A. 56; 26 L. R. A. 470; *Abbott v. Omaha Smelting Co.*, 4 Nebr. 416, 424-425; *Kaiser v. Laurence Savings Bank*, 56 Iowa 104; 8 N. W. 772; 41 Am. Rep. 85; *Bigelow v. Gregory*, 73 Ill. 197; *Loverin v. McLaughlin*, 161 Ill. 417; 44 N. E. 99; *Bergeron v. Hobbs*, 96 Wisc. 641; 71 N. W. 1056; 65 Am. St. Rep. 85; *Duke v. Taylor*, 37 Fla. 64; 19 So. 172; 53 Am. St. Rep. 232; 31 L. R. A. 484; *Garnett v. Richardson*, 35 Ark. 144; *Guckert v. Hacke*, 159 Pa. St. 303; 28 Atl. 249; *Martin v. Fewell*, 79 Mo. 401; *Whipple v. Parker*, 29 Mich. 369; *Owen v. Shepard*, 59 Fed. 746; 8 C. C. A. 244 (holding

and *ex delicto*.¹ Although this rule is accepted by the weight of authority, yet some cases hold that the members are not liable as partners² but that only those members who actually participate in making the contract or in committing the tort are liable. In cases of contract, according to these authorities, the liability is that of agents who have contracted on behalf of a non-existent principal.³ These authorities proceed on the ground that the several members never intended to assume the position of co-partners and never held themselves out as occupying that relation, so that injustice would be done by

that where persons carrying on business under a company name are sued as partners, the burden of proof rests upon them to prove the company to be incorporated); *Sexton v. Snyder*, 119 Mo. App. 668; 94 S. W. 562; *Chaffe v. Ludeling*, 27 La. Ann. 607; *Globe Publishing Co. v. State Bank*, 41 Nebr. 175, 188, 189; 59 N. W. 683; 27 L. R. A. 854 (semble); *Empire Mills v. Alston Grocery Co.*, 4 Willson Civ. Cas. (Tex.), § 221.

Cf. *N. Y., etc. Bank v. Crowell*, 177 Pa. St. 313; 35 Atl. 613; *Patterson v. Arnold*, 45 Pa. St. 410; *Wells v. Gates*, 18 Barb. (N. Y.) 554; *Fuller v. Rowe*, 57 N. Y. 23 (holding that a person is not liable for debts contracted before he became a member of the supposed corporation); *Hyatt v. Van Riper*, 78 S. W. 1043; 105 Mo. App. 664 (where defendants had made false representations about the company, but which is disapproved in part in *Webb v. Rockefeller*, 195 Mo. 57; 93 S. W. 772); *Booth v. Wonderly*, 36 N. J. Law 250 (where the directors were declared to be liable as partners). So such an association may be held subject to the Bankrupt Act as a partnership *Davis v. Stevens*, 104 Fed. 235.

It is a different question whether the members of a corporation are liable as partners upon *ultra vires* contracts. See *Trowbridge v. Scudder*, 11 Cush. (Mass.) 83; *Medill v.*

Collier, 16 Oh. St. 599; and *infra*, § 1641. Sometimes, by statute, individual liability is expressly imposed on members or officers of an association which fails to observe some particular requirement of the incorporation law. See *Loverin v. McLaughlin*, 161 Ill. 417.

¹ *Vredenburg v. Behan*, 33 La. Ann. 627 (liability for keeping ferocious wild animals).

Cf. *Mandeville v. Courtright*, 142 Fed. 97; 73 C. C. A. 321 (as to liability of members of a corporation for torts committed in the course of an *ultra vires* business).

² *Humphreys v. Mooney*, 5 Colo. 282, 288-292; *Fay v. Noble*, 7 Cush. 188; *Stafford Bank v. Palmer*, 47 Conn. 443; *Planters', etc. Bank v. Padgett*, 69 Ga. 159; *Rutherford v. Hill*, 22 Oreg. 218; 29 Pac. 546; 29 Am. St. Rep. 596; 17 L. R. A. 549; *Johnson v. Corser*, 34 Minn. 355; 25 N. W. 799.

Cf. *Central City Savings Bank v. Walker*, 66 N. Y. 424; *Seacord v. Pendleton*, 55 Hun (N. Y.) 579; 9 N. Y. Supp. 46; *State v. How*, 1 Mich. 512 (where the object of the attempted corporation was deemed illegal); *Blanchard v. Kaull*, 44 Cal. 440.

³ *Johnson v. Corser*, 34 Minn. 355; 25 N. W. 799; *Fay v. Noble*, 7 Cush. (Mass.) 188, 194 (headnote inadequate).

Cf. *Hurt v. Salisbury*, 55 Mo.

treating them as such. But this argument, although specious, is believed to be fallacious. Although it is true that the members of the association did not intend to become partners, they did intend to engage in a joint enterprise as an associated body.¹ Now, the law knows but two forms of associations for business or trade — corporations and partnerships; and as they are not a corporation they must be a partnership. This doctrine, however, of a partnership by legal construction does not apply unless the members actually authorize the transaction of business, although their mistaken belief that they had become incorporated is immaterial. Where, however, the members do authorize the transaction of business, they are to be treated in law as a partnership except as to those attributes of a corporation which it is competent for persons to assume by mere agreement. Their belief that they were incorporated is simply a mistake of law, which may be quite disregarded.

A creditor of a defectively incorporated association who obtains a judgment against the company as a corporation is thereafter precluded from holding the members individually liable as partners.² The claim is merged in the judgment against the supposed corporation.

§ 293 a. **Rights and Liabilities Inter Sese.** — To be sure, as the members of a defectively incorporated association intend to become a corporation and not a firm, their rights *inter sese* will be governed by the principles applicable to members of a corporation rather than to co-partners,³ so far, that is, as it is competent for partners by mere agreement to provide that the

¹ In this respect they differ from promoters of a company. Consequently, a suit framed upon the theory that defendants are liable as members of a defectively incorporated association is not sustainable by proof of facts which would create a liability as promoters of a prospective corporation. See *infra*, § 360.

² *Nebraska Nat. Bank v. Ferguson*, 49 Nebr. 109; 68 N. W. 370; 59 Am. St. Rep. 522; *Pittsburg Sheet Mfg. Co. v. Beale*, 204 Pa. St. 85; 53 Atl. 540; *Heuer v. Carmichael*, 82 Iowa 288; 37 N. W.

1034; *Cresswell v. Oberly*, 17 Ill. App. 281. See *supra*, p. 234, n. 2.

³ *Cannon v. Brush Electric Co.*, 96 Md. 446; 54 Atl. 121; 94 Am. St. Rep. 598; *Heald v. Owen*, 79 Iowa 23.

Cf. *Heck v. McEwen*, 12 Lea (Tenn.) 97, 101; *Ward v. Brigham*, 127 Mass. 24; *Lincoln Park Chapter v. Swatek*, 68 N. E. 429; 204 Ill. 228; *Card v. Moore*, 68 N. Y. App. Div. 327; 74 N. Y. Supp. 18, affirmed short, 173 N. Y. 598; 66 N. E. 1105 (where the parties did not regard themselves as incorporated); *Stowe v. Flagg*, 72 Ill. 397; *Coleman v. Coleman*, 78 Ind.

principles of corporate management shall apply to them. Hence, it would seem that there is no implied agency of each shareholder for the association,¹ but that only the directors and other duly constituted agents can bind the company.

§ 294. **Rights against Third Persons.** — As the members of an association who erroneously believe themselves to be incorporated are in law members of a partnership and liable as such to third persons, it follows also that they enjoy the rights of partners as regards third persons. Consequently, a deed conveying land or chattels to them by the supposed corporate name would vest title in them as joint tenants or tenants in common.² The supposed corporate name is treated as a mere description of the individual members. If, however, the members of the

344 (holding that one member of a defectively incorporated company cannot on buying in a claim against the company enforce it against his fellow-members); *Hill v. Beach*, 12 N. J. Eq. 31 (a case decided before the modern law of corporations had taken shape and containing much that would not now be accepted as law); *Johnson v. Corser*, 34 Minn. 355; 25 N. W. 799 (as to implied agency of every member); *Curtis v. Tracy*, 169 Ill. 233; 48 N. E. 399; 61 Am. St. Rep. 168 (director participating in transaction of business before recording of certificate cannot hold associates liable as partners on claim contracted in his favor); *Foster v. Moulton*, 35 Minn. 458; 29 N. W. 155 (where the court thought that a company might be a corporation *de facto* as between the members but not as regards strangers).

As to rights of members who have been held liable to creditors, or who have incurred expenses, to contribution from their associates, see *Richardson v. Pitts*, 71 Mo. 128; *Flagg v. Stowe*, 85 Ill. 164.

¹ See cases cited in last note.

² *Wray v. Wray* (1905), 2 Ch. 349 (where a deed of land to "Wm. W. of Laurel House" was held to convey legal title to a firm composed

of the widow and children of Wm. W., deceased, and carrying on business under his name); *Maugham v. Sharpe*, 17 C. B., n. s., 443 (chattel mortgage to a supposed corporation); *Byam v. Bickford*, 140 Mass. 31; 2 N. E. 687 (deed to a voluntary association by its name).

Cf. *Clifton Heights Land Co. v. Randell*, 82 Iowa 89; 47 N. W. 905; *American Silk Works v. Salmon*, 6 T. & C. (N. Y.) 352; *White Oak Grove Benev. Soc. v. Murray*, 145 Mo. 622; 47 S. W. 501 (holding that equitable title passes and that a bill in equity will lie to compel grantor to execute a new deed); *Reinhard v. Virginia Lead Mining Co.*, 107 Mo. 616 (proceeding on the ground of estoppel and explaining *Douthitt v. Stinson*, 63 Mo. 268, and *Arthur v. Weston*, 22 Mo. 379, on the ground that they related altogether to the legal as distinguished from the equitable title); *Whipple v. Parker*, 29 Mich. 369; *Hart v. Seymour*, 147 Ill. 598, 610; 35 N. E. 246.

But see *Prevost v. Morgan's, etc. R. R. Co.*, 42 La. Ann. 809; 8 So. 584; *German Land Ass'n v. Scholler*, 10 Minn. 331; *Childs v. Hurd*, 32 W. Va. 66, 100 (declaring the deed to be "null and void").

defectively incorporated body are not ascertainable but consist in an indefinite, fluctuating number of individuals — for example, the members of a church or congregation — the conveyance cannot vest title in them as individuals but is void for uncertainty,¹ unless indeed it can be sustained as a charity. It has been held that a promissory note payable to the order of a railroad company which in point of fact is not incorporated is in legal effect payable to a fictitious payee;² but on principle it would certainly seem that if any such company is in existence, although it be unincorporated, the note should be regarded as payable to the members or shareholders jointly or as partners. Upon the same principle that (except when the doctrines of estoppel or of *de facto* corporations come into play) the members of a defectively incorporated association are entitled to the rights of partners as against third persons, it follows that the members of an association, organized, though defectively, under a general incorporation law may sue as a partnership for the protection of the joint property.³

¹ *State use Trustees M. E. Church v. Warren*, 28 Md. 338; *German Land Association v. Scholler*, 10 Minn. 331.

² *Farnsworth v. Drake*, 11 Ind. 101.
³ *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143.

CHAPTER V

INCORPORATION FOR ILLEGAL PURPOSES

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§ 295. **Illegal Purpose distinguished from merely unauthorized Purpose.** — Although the books are full of cases on irregular or defective incorporation, very little authority exists on questions relating to incorporation for illegal purposes. To be sure, some law can be found on the subject of unauthorized incorporation — that is, incorporation or attempted incorporation for some object innocent enough in itself but not among the objects for which the incorporation laws make provision as the objects of an incorporated company.¹ But this subject is so closely connected with the topic of irregular or defective incorporation, even if it is not identical with it, and with the topic of the object clause of the incorporation paper, that separate treatment is undesirable.

Moreover, it is important to distinguish cases relating to unincorporated companies which are illegal not because of any inherent illegality in their objects — that is, not because it would be illegal for an individual to pursue the same objects — but because of some statute forbidding the formation of voluntary associations of the character of the company in question. The most striking illustrations of illegal voluntary associations of

¹ See *supra*, § 121, and § 286. J. 98, 121-122 (per Page Wood, Cf. *Butt v. Monteaux*, 1 K. & V. C.).

this kind are furnished by the British Companies Act of 1862, which prohibits the formation of companies with more than a certain number of members unless registered under that act or formed in pursuance of some other act of parliament or of letters patent, etc.¹ In such cases, there is no attempt to become incorporated, and consequently there is certainly no corporation either *de jure* or *de facto*. Such cases are, therefore, to be distinguished from cases where would-be incorporators go through formalities prescribed by general incorporation laws, for illegal purposes. Nevertheless, the English books referring to companies formed in violation of the statutory prohibition constantly use the general phrase "illegal companies,"² and discrimination must therefore be exercised in relying upon these English cases and text-writers as authorities in America. When an English judge or lawyer speaks of an "illegal company," he generally means not a company which has attempted to become incorporated for illegal purposes but a voluntary association which is illegal because of the prohibition in the Companies Acts.³

§ 296-§ 297. *Incorporation avowedly for Illegal Purpose.*

§ 296. In general. — Suppose, however, the objects for which a corporation is sought to be organized are not merely

¹ "No company, association, or partnership consisting of more than ten persons shall be formed, after the commencement of this Act, for the purpose of carrying on the business of banking, unless it is registered as a company under this Act, or is formed in pursuance of some other Act of Parliament or of letters patent; and no company, association, or partnership consisting of more than twenty persons shall be formed after the commencement of this Act, for the purpose of carrying on any other business that has for its object the acquisition of gain by the company, association or partnership, or by the individual members thereof, unless it is registered as a company under this Act, or is formed in pursuance of some other Act of Parliament, or of letters patent, or is a company engaged in

working mines within and subject to the jurisdiction of the Stannaries." Companies Act, 1862, § 4.

² E. g. 1 Lindley on Companies, 6th ed., Bk. I, Chap. 5. The general language used in parts of this chapter especially § 2, pp. 189-192, may be useful as authority for American lawyers; but the cases cited by Lord Lindley, when analyzed, will often if not generally be found to be inapplicable to American conditions.

³ But compare *Ilfracombe Permanent Mut. Benefit Bldg. Soc.* (1901), 1 Ch. 102, 112, where Wright, J., protested against this use of the word illegal and preferred the phrase "a society not authorized by law and therefore not existing, from the point of view of the Companies Acts, as a society at all."

unauthorized but even actually illegal. Of course, any instance of this sort is a special case under the general class or head above referred to of corporations, or intended corporations, formed with objects for which the incorporation law does not provide. For no incorporation act, however liberal or even loose it may be, permits persons to incorporate for the purpose of violating the laws — of performing acts that are either *mala in se* or *mala prohibita*. If therefore any company is avowedly organized for any such purpose and if the illegal purpose appears on the face of the company's memorandum of association or incorporation paper, the company certainly does not become a corporation *de jure*,¹ and (unless there be other and lawful objects) probably not even a corporation *de facto*.² Other consequences, pains, and penalties may attach to those who engage in or promote such an organization, but that such persons certainly do not become incorporated *de jure* and probably not even *de facto* is clear.

For example, all lawyers remember the traditional case of a bill for a partnership accounting by a member of a firm of highwaymen.³ If an enterprising, up-to-date firm of that character should attempt to become incorporated under the laws of New

¹ *Woodberry v. McClurg*, 29 So. 514; 78 Miss. 831 (purchasing shares of other companies in violation of an anti-trust law); *State v. Debenture Guarantee, etc. Co.* (La.), 26 So. 600, affirmed as to federal questions *sub nom. New Orleans Debenture, etc. Co. v. Louisiana*, 180 U. S. 320; 21 Sup. Ct. 378.

Cf. *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497.

² *Detroit Schuetzen Bund v. Detroit Agitations Verein*, 44 Mich. 313; 6 N. W. 675; 38 Am. Rep. 270 (opposing enforcement of liquor law); *St. Louis Colonization Ass'n v. Hennessy*, 11 Mo. App. 555, 557 (headnote inadequate — *semble*).

Cf. *Trustees of N. C. Endowment Fund v. Satchwell*, 71 N. Car. 111 (special act incorporating company for the purpose of dispensing charity to orphans of Confederate soldiers, held to be unconstitutional and to

create no corporation); *Chicora Co. v. Crews*, 6 S. Car. 243; *Padstow Total Loss & Collision Ass. Ass'n*, 20 Ch. D. 137 (company formed with more than twenty members in violation of the Companies Act, held to have no existence and therefore to be incapable of being wound-up as a company (under the winding-up acts).

But see *Lincoln Bldg., etc. Ass'n v. Graham*, 7 Nebr. 173 (headnote inadequate — lending at usurious interest); *New Orleans Debenture, etc. Co.*, 180 U. S. 320, 327–328; 21 Sup. Ct. 378 (holding that as a *de facto* corporation the company may properly be made the sole defendant in a proceeding by the state to test the validity of the incorporation).

³ *Everet v. Williams*, 9 Law Quarterly Rev. 197; Lindley on Partnership, 7th ed., p. 107. The bill was dismissed with costs and the plaintiff's solicitors were fined for contempt.

Jersey, and should frankly state in their incorporation papers that the only object of the proposed company would be to engage in highway robbery, manifestly the company's object would not be a lawful purpose within the meaning of the New Jersey law, and therefore the attempt to become incorporated would be wholly nugatory. The same thing would be true if the company's avowed object instead of being in conflict with some state law should be the violation of an act of Congress. Hence, if the incorporation paper of some company should state as its sole object the monopolization of interstate commerce in violation of the Sherman Anti-Trust Law, the attempt to incorporate would be simply and wholly ineffectual.

However, the inclination of the courts is — and very properly — to presume that the incorporation papers do not contemplate illegal objects. For instance, when during the Civil War, a corporation was formed in Georgia for the purpose of trade with foreign countries, it was held that the expressed object of the company was not illegal, notwithstanding the existence of the blockade then maintained by the federal fleets, since the corporation might conclude to wait until the raising of the blockade.¹

§ 297. **Effect of Illegality of Company upon Contracts.** — In a case of incorporation for illegal purposes, not merely is the company no corporation, but contracts relating to its formation and operation will be illegal. Upon this point, cases relating to English voluntary companies formed in defiance of the prohibition in the Companies Acts may perhaps be referred to. A subscription to shares in an illegal company is itself an illegal contract; and until the illegal purpose be carried out by the actual formation of the company, amounts paid on the subscription may be recovered back. Contracts for sale of shares in the illegal company are, it seems, likewise illegal.² Moreover, it

¹ *Importing & Exporting Co. v. Locke*, 50 Ala. 332, 334. (where the company was illegal under the Bubble Act).

But cf. *Chicora Co. v. Crews*, 6 S. Car. 243 (where a special act of the legislature of South Carolina passed during the War purporting to create a corporation for the purpose of exporting produce and importing arms was held to be void). Cf. *Buck v. Buck*, 1 Campb. 547 (holding that a purchaser of shares, in a company which was illegal under the Bubble Act, could not maintain an action for money had and received against his broker to recover the balance remaining of money deposited with him to make the

² *Josephs v. Prebber*, 3 B. & C. 639

seems even to have been held that a debtor owing money to an illegal association may escape payment to any one.¹ Moreover, a member of the illegal association cannot maintain an action against his associates or trustees to require an accounting or to hold the trustees liable for breaches of trust.² On the other hand, the illegal character of the association is no answer to a criminal prosecution for embezzling its funds.³

§ 298—§ 302. *Incorporation ostensibly for Lawful but really Illegal Purposes.*

§ 298. **Likelihood that Illegal Purpose will be veiled.** — Those who engage in illegal transactions are unlikely frankly to state their real object; they are much more apt to attempt to conceal their actual intentions under the mist of innocent general terms. For example, it will be remembered that the traditional highwayman's partnership bill to which reference was made in a former paragraph alleged that the object of the firm was to "deal with gentlemen for watches, rings, swords, canes, hats, cloaks, horses, bridles, saddles, and other things." Accordingly, when the promoters of a corporation design to use the company for illegal ends, they do not avow their intent to break the law but on the contrary state in the incorporation paper as their ostensible object some perfectly legitimate business, secretly intending so to conduct that business as to compass unlawful ends.

purchase); *Bousfield v. Wilson*, 16 M. & W. 185 (semble, that vendor of shares in a company which was illegal because of the prohibition in the Companies Acts could maintain an action against his broker to recover the purchase price).

¹ *Ex parte Day*, 1 Ch. D. 699, 702 ("prima facie, the (illegal) society is not entitled to share in the distribution of the debtor's assets"); *Jennings v. Hammond*, 9 Q. B. D. 225 (substantially the same point as *Shaw v. Benson*, stated infra); *Re Thomas*, 14 Q. B. D. 379, 383 (semble).

In *Shaw v. Benson*, 11 Q. B. D. 563, it was held that in a case

of a loan society which, consisting of more than twenty members, was held to be prohibited by the Companies Act and therefore illegal, a loan to a member to be repaid according to the society's rules was illegal, so that no recovery could be had upon a promissory note, payable to one of the society's officers, given to secure the loan; but at the same time, Brett, M. R., said: "It was contended that an 'illegal person' made the contract illegal: that is an argument with which I cannot agree." 11 Q. B. D. 571.

² *Sykes v. Beadon*, 11 Ch. D. 170.

³ *Regina v. Tankard* (1894), 1 Q. B. 548.

§ 299. **Company incorporated De Facto.** — In any case of this sort, since the memorandum of association or incorporation paper is fair on its face, the courts, in order to protect innocent persons who may become shareholders in the company, or who may have dealings with it, are obliged to hold that the company comes into existence as a corporation, at least as regards all the world except the sovereign,¹ although any public registrar or other officer who is required to approve the paper may withhold approval on account of the secret illegal purpose.² For example, when an insolvent corporation comes to be wound-up a shareholder cannot escape liability on the ground that the real object of the company was gambling.³ So, the corporation itself in spite of its secret illegal object may compel shareholders to pay their unpaid subscriptions.⁴ On the same principle, it is no defence to a suit to enforce a deed of trust securing an issue of bonds that the company was incorporated for the illegal purpose of creating a monopoly,⁵ although to be sure a court of equity

¹ *U. S. Vinegar Co. v. Schlegel*, 143 N. Y. 537; 38 N. E. 729; *U. S. Vinegar Co. v. Foehrenbach*, 148 N. Y. 58; 42 N. E. 403; *Clancey v. Onondaga Fine Salt Mfg. Co.*, 62 Barb. (N. Y.) 395.

Cf. *Patterson v. Arnold*, 45 Pa. St. 410 (overruled in *Cochran v. Arnold*, 58 Pa. St. 399); *Importing & Exporting Co. v. Locke*, 50 Ala. 332 (company formed in Georgia during the Civil War for trade with foreign countries, the real intention being to run the blockade established by the federal government); *Attorney-General v. Am. Tobacco Co.*, 55 N. J. Eq. 352, 376; 36 Atl. 971, affirmed on opinion below, 56 N. J. Eq. 847; 42 Atl. 1117; *Finck v. Schneider Granite Co.*, 187 Mo. 244, 267-268 (headnote misleading); 86 S. W. 213; 106 Am. St. Rep. 452; *State v. New Orleans Water Supply Co.* (La.), 36 So. 117, 122; 111 La. 1049 (where the court said "The question whether a corporation has been organized for an illegal purpose must be determined by the provisions of its charter and not by

the declarations of its officers or agents"); *Haacke v. Knights of Liberty, etc., Club*, 76 Md. 429.

But the corporate fiction does not protect the members from individual liability for moneys deposited in pursuance of the illegal scheme. *McGrew v. City Produce Exchange*, 85 Tenn. 572; 4 S. W. 38; 4 Am. St. Rep. 771; *Brundred v. Rice*, 49 Oh. St. 640; 32 N. E. 169; 34 Am. St. Rep. 589 (promoters of company formed to receive illegal rebates from a railway company liable individually to other shippers for amount of rebates).

² *First Church of Christ, Scientist*, 205 Pa. St. 543; 55 Atl. 536; 97 Am. St. Rep. 753; 63 L. R. A. 411.

³ *Augir v. Ryan*, 63 Minn. 373; 65 N. W. 640.

⁴ *U. S. Vinegar Co. v. Foehrenbach*, 148 N. Y. 58; 42 N. E. 403; *Detroit Driving Club v. Fitzgerald*, 109 Mich. 670; 67 N. W. 899.

⁵ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 195-196; 20 Sup. Ct. 311.

will not enjoin a violation of one of the terms of a contract other parts of which provide for the organization of the company for a secret illegal purpose.¹ Moreover, the company is not prevented from protecting its property by bill for an injunction by the illegality of the purpose for which it may have been incorporated.² To be sure, in one case a federal court applying the maxim *in pari delicto potior est conditio defendentis*, refused to interfere in the internal affairs of a corporation which had been formed ostensibly for a lawful but secretly for an illegal purpose.³ Moreover, as regards parties who were privy to the illegal intent, the case may be treated as if the illegality appeared on the face of the incorporation proceedings,⁴ so that such a party cannot recover for money lent to the company in furtherance of the unlawful purpose.⁵ But the attempt to incorporate is not a mere nullity.

§ 300. **Ouster from corporate Privileges at Suit of Sovereign.**—Nevertheless, the promoters have undoubtedly wrought a fraud on the incorporation act. The statute extended its benefits to those who might desire to incorporate for any lawful purpose, but it has been availed of by persons whose ostensible object was lawful enough but whose real purpose is illegal. Hence, in such a case the law ought to furnish some means of vindicating its own dignity and ousting from the enjoyment of its privileges those who have abused its provisions.

In England, however, serious doubt has been entertained whether any proceeding in the nature of *quo warranto* or *scire facias* to revoke a charter would lie in such a case.⁶ In most of the United States, if not in all of them, on the other hand, some proceeding to oust the wrongdoers from the enjoyment of corporate privileges could beyond doubt be maintained by the attorney-general.⁷ In the enforcement of this quasi-penal remedy

¹ *McConnell v. Camors-McConnell Co.*, 152 Fed. 321.

² *American Steel, etc. Co. v. Wire Drawers', etc. Unions*, 90 Fed. 608, 614 (injunction against strikers).

³ *Le Warne v. Meyer*, 38 Fed. 191.

⁴ See *supra*, § 296, § 297.

⁵ *Euston v. Edgar* (Mo.), 105 S. W. 773.

⁶ See *Salomon v. Salomon & Co.*

(1897), A. C. 22, 30; *Reuss v. Bos*, L. R. 5 H. L. 176, 193.

⁷ *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 196; 20 Sup. Ct. 311 (semble); *State ex inf. Hadley v. Meramec Rod, etc. Club* (Mo.), 98 S. W. 815; *State ex inf. Hadley v. Delmar Jockey Club* (Mo.), 92 S. W. 185; *Attorney-General v. Am. Tobacco Co.*, 55 N. J. Eq. 352, 376; 36

the courts would take care that the rights of innocent parties should not be prejudiced. Moreover, proof would probably be required not merely of the illegal intent but also of the execution of that intent by illegal acts. In Ireland, it has been held that where a company is incorporated for the purpose of deceiving the public, the attorney-general is entitled to an injunction to restrain the perpetration of the fraud.¹

§ 301. **No chartered Right to execute Illegal Purpose.** — At all events, both in England and America, every lawyer would agree that the formation of a corporation ostensibly for an innocent but really for an illegal or criminal purpose confers no chartered right to commit the violation of law,² and that any remedies whether for the prevention of the wrong if not yet consummated or for the undoing of it if already perpetrated may be availed of precisely as if the incorporation had never been effected.³ An illustration may be found in the numerous cases in which corporations have been enjoined from using their corporate names where such use would involve an infringement of the trade name of some prior organization.⁴ The registration of a company under a general incorporation law gives it no license to commit crimes or torts.

Atl. 971 (semble), affirmed on opinion below in 56 N. J. Eq. 847; 42 Atl. 1117 (holding that the attorney-general cannot proceed in equity); *State v. Nebraska Distilling Co.*, 29 Nebr. 700 (illegal restraint of trade); *People v. Milk Exchange*, 77 Hun (N. Y.), 436; 29 N. Y. Supp. 259 (illegal restraint of trade); *State ex rel. Voyles v. French Lick Springs Hotel Co.* (Ind.), 82 N. E. 801 (holding that where the corporation has actually engaged in illegal transactions it is no defence that it has also carried out its proper, innocent purposes).

Cf. *Attorney-General ex rel. Wolverine Fish Co. v. A. Booth & Co.*, 143 Mich. 89; 106 N. W. 868. See also *infra*, p. 265.

¹ *Attorney-General v. Appleton* (1907), 1 Ir. 252; *Attorney-General v. Myddletons* (1907), 1 Ir. 471.

² *Distilling, etc. Co. v. People ex rel. Malony*, 156 Ill. 448; 41 N. E.

188; 47 Am. St. Rep. 200; *Southern Electric Securities Co. v. State* (Miss.), 44 So. 785 (stated *infra*, p. 265, n. 1).

Cf. *People ex rel. Peabody v. Chicago Gas Trust Co.*, 130 Ill. 268; 22 N. E. 798; 17 Am. St. Rep. 319; 8 L. R. A. 497.

³ Cf. *Richardson v. Buhl*, 77 Mich. 632; 6 L. R. A. 457; 43 N. W. 1102 (where a contract relating to the furtherance of the illegal enterprise was pronounced void); *Finck v. Schneider Granite Co.*, 187 Mo. 244; 86 S. W. 213; 106 Am. St. Rep. 452 (same point as preceding case); *Jones v. Missouri-Edison Electric Co.*, 144 Fed. 765; 75 C. C. A. 631 (company formed for fraudulent purpose); *State v. Collins* (R. I.), 67 Atl. 796 (officer indictable for conducting criminal business as agent of the corporation).

⁴ See *infra*, § 454.

§ 302. *Northern Securities Co. v. United States*, 193 U. S. 197. — Failure to recognize these considerations was the underlying fallacy in one of the arguments advanced on behalf of the defendant in a famous recent case — the Northern Securities Case.¹ It will be remembered that the Northern Securities Company had been incorporated under the general laws of New Jersey for the purpose, as the “certificate of incorporation,” or incorporation paper, somewhat more wordily stated, of buying, holding, and selling corporation stocks and bonds — a quite legitimate business. The real purpose of the incorporation, however, was the stifling of competition between two interstate railways through acquiring and holding a majority, or all, of the shares of each of them. This object, the Supreme Court held, was prohibited by the Sherman Anti-Trust Act. The soundness of this conclusion, while doubtless debatable, in no way turns on questions of corporation law, and therefore does not concern us here. But assuming this construction of the act to be correct, the counsel for the Northern Securities Company argued that nevertheless that company, being validly incorporated under the laws of New Jersey, had, by virtue of the powers conferred upon it by its incorporation paper, the same right as a natural person to purchase and hold shares in competing railway companies. The obvious answer to this contention was that if, as was conceded, the object of the incorporation was the prevention of competition between two competing interstate railways by uniting the ownership of a controlling interest in each, and if this object was a violation of an act of Congress, then the company was not really formed for a “lawful purpose” within the meaning of the New Jersey incorporation act, and its organization was in effect a fraud on the laws of New Jersey. The formation of a company for the purpose of violating an act of Congress was as much a fraud on the New Jersey incorporation law as if the company’s object had been the infringement of a New Jersey statute. Hence, the rights and dignity of the State of New Jersey, so far from being concerned in upholding a power in the Northern Securities Company to violate with im-

¹ *Northern Securities Co. v. U. S.*, Eq. 352; 36 Atl. 971, affirmed on 193 U. S. 197; 24 Sup. Ct. 436. opinion below, 56 N. J. Eq. 847;

With this case, compare *Attorney-General v. Am. Tobacco Co.*, 55 N. J. 42 Atl. 1117.

punish an act of Congress, demanded that, if the federal statute forbade what the company had done and was formed for the purpose of doing, then vigorous steps should be taken to prevent the continuance of the illegal action on its part and to vindicate the outraged corporation law of New Jersey, which provided for the incorporation of companies for lawful purposes, and which had been abused by the organization of a company for the purpose of violating a law of the United States. For this reason, the federal court was justified in enjoining the defendant corporation, the Northern Securities Company, from exercising rights of ownership in respect of the shares which it had acquired in defiance of the Anti-Trust Law.¹ If this decision rested upon a sound interpretation of the act of Congress in question, it certainly interfered in no way with the rights of New Jersey or with those conferred by that state on its creature, the Northern Securities Company. Indeed, a New Jersey court, accepting as sound the construction placed by the Supreme Court on the Anti-Trust Law, might well have gone a step further by dissolving the corporation and decreeing a forfeiture of its corporate privileges because of its abuse of the New Jersey law by organizing a corporation under legal forms for the secret purpose of violating a federal statute.²

§ 303-§ 306. *What Purposes are Illegal.*

§ 303. **Not usually a Question of Corporation Law.**—Of course, the question whether the purpose for which a company is organized is legal or is illegal is a question of general law, not of corporation law. For example, in the Northern Securities Case, the question whether the Anti-Trust Law, fairly construed, really did prohibit a combination among the owners of stock in two competing interstate railways in order to consolidate their holdings under a common management is purely a question in the law of monopolies and restraints on commerce. The only

¹ *Southern Electric Securities Co. v. State* (Miss.), 44 So. 785 (where the Mississippi court at the suit of the state of Mississippi enjoined a New Jersey corporation, which had been formed to acquire the stock of competing Mississippi corporations, from voting in respect of the shares so acquired in defiance of a Mississippi Anti-Trust law).

² See *supra*, § 300.

point in the law of corporations which the case decides has been discussed above.

§ 304. **Violation of Provisions of Incorporation Law.** — To be sure, the illegality alleged to lurk in the object of a company's organization may consist in the intention to violate or evade some provision of the incorporation law itself. For example, in the well-known case of *Salomon v. Salomon & Co.*,¹ where a company was organized to take over a mercantile business previously carried on by a certain Aaron Salomon, the contention was advanced that inasmuch as Salomon owned all the shares in the company except six (which were taken by other members of his family) the company was a mere device to enable an individual to carry on business with limited liability, and that such a device was a violation of the spirit of the Companies Act and was unlawful, and that therefore the company never became validly incorporated. This argument was, however, overruled by the House of Lords upon the ground that the law did not prohibit the incorporation of a company for the purpose of carrying on business with limited liability, provided only the formalities prescribed in the incorporation act be observed.² Any other conclusion would have been truly startling. For both in England and America, a very large proportion of all the companies incorporated are organized for the mere purpose of avoiding the unlimited liability which attaches to an individual or partnership carrying on business. If all these companies were to be held illegal, and the attempted incorporation invalid, or capable of invalidation, the consequences would have been appalling.

Incorporation laws often require that the company's principal office or place of business be stated in the incorporation paper. If the instrument be fair on its face but if the company be organized without a *bona fide* intention of carrying on business at the designated place, the validity of the incorporation may certainly be called in question by the state on *quo warranto* proceedings, and under exceptional circumstances may be attacked collaterally.³

¹ *Salomon v. Salomon & Co.* (1897), invoke the jurisdiction of the A. C. 22 (headnote inadequate). federal courts on the ground of

² See also *Irvine Co. v. Bond*, 74 diversity of citizenship). Fed. 849 (where the motives of ³ *Montgomery v. Forbes*, 148 incorporation were to secure limited Mass. 249; 19 N. E. 342. liability and to obtain the right to But cf. *supra*, § 283, § 287.

§ 305. **Purposes Unlawful but not Criminal.** — The fact that the purpose of incorporation is not a crime is not conclusive proof that the purpose is lawful. For example, the use of a corporate name which involves a false representation is not lawful although the use of that name may not be a crime. Thus, in a recent Irish case, where a corporation was proposed to be formed under the name of "S. G. Rowell, Dentist, Limited," the court held that the proposed name would falsely suggest that either S. G. Rowell or the corporation was licensed to practise dentistry and that therefore the object of the company was not lawful,¹ notwithstanding a prior decision in which the use by a corporation of a name including the words "Surgeon Dentists" had been held not to be a violation of the act for the licensing of dentists.²

§ 306. **Purposes contrary to Public Policy.** — Moreover, a corporation cannot be formed for a purpose which, although perhaps not strictly illegal, is deemed to be contrary to public policy.³ For example, an organization for the purpose of paying benefits or premiums to members upon their marriage has been thought to be against public policy; and therefore it was held that a corporation could not be formed for that purpose.⁴

¹ *Rez v. Registrar Joint Stock Companies* (1904), 2 Ir. 634.

Cf. *Attorney-General v. Appleton* (1907), 1 Ir. 252; *Attorney-General v. Myddletons* (1907), 1 Ir. 471.

² *O'Duffy v. Jaffe* (1904), 2 Ir. 27.

³ *Detroit Schuetzen Bund v. Detroit Agitations Verein*, 44 Mich. 313 (headnote inadequate); 6 N. W. 675; 38 Am. Rep. 270.

Cf. *Benevolent Society*, 10 Phila. (Pa.) 19; *First Church of Christ, Scientist*, 205 Pa. St. 543; 55 Atl. 536; 97 Am. St. Rep. 753; 63 L. R. A. 411 (incorporation for the purpose of healing disease by prayer alone).

⁴ *Helping-Hand Marriage Ass'n*, 15 Phila. 644.

CHAPTER VI

PROMOTERS

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§ 307-§ 310. *Who are Promoters.*

§ 307. **In general — Not a definite legal Term.** — The word “promoter” is not a technical legal term, or “word of art,” but belongs rather to the vocabulary of commercial affairs.¹ Consequently, it is capable of no precise legal definition applicable to all cases. In a general way, it designates any person who knowingly participates in organizing and starting in business an incorporated company.² The state of being a promoter is not a definite legal status — such as that of a shareholder or a director — to which the law annexes certain rights and burdens. “It is necessary to ascertain in each case what the so-called

¹ *Whaley Bridge Co. v. Green*, 5 Q. B. D. 109, 111, per Bowen, J.; *Twycross v. Grant*, 2 C. P. D. 469, 503 (per Bramwell, L. J.); *Pitts v. Steele Mercantile Co.*, 75 Mo. App. 221, 226. *langer v. New Sombrero Phosphate Co.*, 3 App. Cas. 1218, 1268; *Cox v. National Coal, etc. Co.* (W. Va.), 56 S. E. 494. Cf. *South Missouri, etc. Co. v. Crommer* (Mo.), 101 S. W. 22 (where the persons in question were held not to be promoters).

² *Emma Silver Mining Co. v. Lewis*, 4 C. P. D. 396, 407; *Twycross v. Grant*, 2 C. P. D. 469, 541; *Er-*

promoter really did before his legal liabilities can be accurately ascertained.”¹

§ 308. **Who are subject to Disability as Promoters.** — The nearest approach to any definite legal consequences attaching to promoters *qua* promoters is found in that rule of law which prohibits any one engaged in the promotion of an incorporated company from deriving any secret advantage from his position. In order that a person may be subject to this disability, he need only participate intentionally in the organization or “flotation” of the company.² It would seem clear that a mere intention of getting up a company without any overt act will not make a man a promoter or create any fiduciary relationship.³ But in order to be a promoter, it is not necessary that he should act as a principal; a mere agent or servant of one financially interested in the promotion of the company is deemed himself a promoter within this rule.⁴ So, the officers of a corporation which is engaged in promoting another corporation are themselves promoters of the latter company.⁵ Of course, a person who employs an agent to get up a company is a promoter; ⁶ *qui facit per alium facit per se*. It has been held that one who acts merely as solicitor for a company in the matters attending and immediately following the incorporation is not a promoter;⁷ but it is submitted that no sound reason can be given for drawing any distinction in this respect between solicitors and other agents or attorneys.⁸ The objection may be raised that the printer who prints a prospectus or a mere clerk to whom it is dictated knowingly participates in the organization of the company, and would therefore according to the rules just stated be subject to a promoter’s disabilities. The reply is that such would indeed be the case,⁹ and that any such printer or clerk who makes a secret profit out of

¹ *Lydney, etc. Co. v. Bird*, 33 Ch. D. 85, 93 (per Lindley, L. J.).

² See *supra*, cases cited p. 271 n. 2.

³ *Re Hess Mfg. Co.*, 21 Ont. App. 66, 71, affirmed, 23 Can. Sup. Ct. 644.

⁴ *Lydney, etc. Co. v. Bird*, 33 Ch. D. 85.

Cf. *Grand Rapids Safety Deposit Co. v. Cincinnati Safe, etc. Co.*, 45 Fed. Rep. 671 (headnote misleading).

⁵ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392.

⁶ *Ex-Mission Land Co. v. Flash*, 97 Cal. 610, 627; 32 Pac. 600.

⁷ *Re Great Wheal Polgroth*, 49 L. T. 20.

⁸ Cf. *Bagnall v. Carlton*, 6 Ch. D. 371.

⁹ “A man who carries about an advertising board in one sense promotes a company.” Per Bowen, J., in *Whaley Bridge, etc. Co. v. Green*, 5 Q. B. D. 109, 111.

his relation to the corporation would be accountable therefor to the company. The great difference between such a subordinate and the more dignified persons whom we are apt to think of as promoters is that the opportunities of the former for making secret profits out of their relationship to the intended corporation are much more limited. On the other hand, an independent contractor by dealing with promoters does not *ipso facto* become himself a promoter; to be a promoter, one must either occupy such a position as would make him an agent of the company if it were already incorporated, or he must in some other way assume the burden of looking after the interests of the unborn corporation.¹ Similarly, a landowner, who employs a broker to sell his property is not to be deemed a promoter of a corporation which the broker without any authority or even suggestion from the landowner organizes for the purpose of purchasing the property.² One who agrees to become a director in a company to be organized becomes from that time a promoter.³ And it would seem very clear that any one who knowingly aids promoters financially and otherwise in carrying out their scheme becomes himself liable to all the disabilities of a promoter.⁴

§ 309. **A Question for Jury.** — At all events, the question whether or not a person is a promoter is a question of fact; and may, it has been held, in actions at law be left to the jury without any definition of the term to guide them.⁵

§ 310. **Promoters after Incorporation.** — The peculiarities of the law applicable to promoters apply not merely while the corporation has no existence save in the brains of its projectors, but also, at least to a large extent, after it has a technical legal existence, but while it is still in a state of undeveloped infancy, and not yet wholly capable of managing its own affairs in the regular manner. Accordingly, one may become a promoter of a

¹ *South Missouri, etc. Co. v. Crommer* (Mo.), 101 S. W. 22.

² *Forest Land Co. v. Bjorkquist*, 110 Wisc. 547; 86 N. W. 183.

³ *Nant-y-Glo, etc. Ironworks Co. v. Grave*, 12 Ch. D. 738.

⁴ *Fountain Spring Park Co. v. Roberts*, 92 Wisc. 345; 66 N. W. 399; 53 Am. St. Rep. 917. The court held the persons in question to the same liabilities and disabili-

ties as promoters; but conceded — unnecessarily, and, it is submitted, without good reason — that they occupied no fiduciary relation to the company.

⁵ *Emma Silver Mining Co. v. Lewis*, 4 C. P. D. 396. This practice seems to have been followed in *Twycross v. Grant*, 2 C. P. D. 469, and *Whaley Bridge Co. v. Green*, 5 Q. B. D. 109.

company after its incorporation,¹ and those who have formerly been promoters do not cease to be such on the registration of the company.² A person who is not a director may be a promoter of a company which is already incorporated but the capital of which has not been subscribed and which has therefore not yet commenced operations as a full-fledged going concern.³ But where a company has been organized and operated by a board of directors for as much as a year, it has been held that the relation of promotorship no longer exists, and that a former promoter may then deal with the company at arm's length.⁴

§ 311-§ 315. *Whether Promoters are Partners.*

§ 311. **In general.** — In spite of some decisions to the contrary,⁵ most of which have been overruled, it is now almost universally held that persons do not become partners merely by co-operating in the formation of a corporation.⁶ This is true both of those whose connection with the project consists merely in subscribing for shares in the intended company⁷ and of those

¹ *Twycross v. Grant*, 2 C. P. D. S. W. 163; *Garnett v. Richardson*, 469, 503, 540, 541.

² *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392, 428; *Pietsch v. Milbrath*, 101 N. W. 388, 391; 102 N. W. 342; 123 Wisc. 647; 107 Am. St. Rep. 1017.

³ *Emma Silver Mining Co. v. Lewis*, 4 C. P. D. 396, 407.

⁴ *Russell v. Rock Run Fuel Gas Co.*, 184 Pa. St. 102, 107-108; 39 Atl. 21.

⁵ *Holmes v. Higgins*, 1 B. & C. 74; *Lucas v. Beach*, 1 Man. & Gr. 417, which cases are explained in Lindley on Partnership, 7th ed., 19.

⁶ See also *Chandler v. Bacon*, 30 Fed. Rep. 538 (where no such point was necessary to the decision, since the liability of promoters for secret profits, like that of directors, is doubtless joint and several); *Getty v. Devlin*, 54 N. Y. 403, 413 (reported on a subsequent appeal in 70 N. Y. 504); *Emery v. Parrott*, 107 Mass. 95; *Dole v. Wooldredge*, 135 Mass. 140; *Queen City Furniture, etc. Co. v. Crawford*, 127 Mo. 356, 364; 30

S. W. 163; *Garnett v. Richardson*, 35 Ark. 144; *Ryland v. Hollinger*, 117 Fed. 216; *Mt. Carmel Tel. Co. v. Mt. Carmel & Fleming Tel. Co.* (Ky.), 84 S. W. 515.

⁷ *Reynell v. Lewis*, 15 M. & W. 517; *Walstab v. Spottiswode*, 15 M. & W. 501; *Batard v. Hawes*, 2 E. & B. 287; *Ward v. Brigham*, 127 Mass. 24; *Hornblower v. Crandall*, 7 Mo. App. 220, 230-231 (semble), affirmed, 78 Mo. 581; *Wilson v. Hotchkiss*, 2 Ont. L. Rep. 261 (semble); *Wilkins v. Davies*, 16 Vict. L. R. 70.

See also *West Point Foundry Ass. v. Brown*, 3 Edw. Ch. 284 (N. Y.); *Schantz v. Oakman*, 10 N. Y. App. Div. 151; 41 N. Y. Supp. 746; and infra, § 359.

The status of persons who form a supposed corporation and, assuming the validity of the incorporation, authorize the transaction of business is elsewhere considered. See supra, § 293.

⁷ *Hutton v. Thompson*, 3 H. L. C. 161; *Ward v. Brigham*, 127 Mass. 24.

who are the active organizers of the corporation.¹ The rule is the same in equity as at law,² and applies whether the promoters anticipate incorporation by royal charter, by special act, or under a general law.³

§ 312. **Under the British Companies Act of 1844 — Outline of Practice.** — The extent to which the doctrine is carried that promoters are not partners is shown by the many and leading cases which arose under the English Companies Act of 1844.⁴ Under this statute, the promoters before issuing a prospectus were required to deposit at the Registry of Joint Stock Companies a schedule containing certain particulars as to the proposed company, including its name, its business or purpose, etc., and the names and addresses of the promoters. Upon the registration of this schedule, the promoters became entitled to a certificate of provisional registration, upon the issuance of which the company was said to be “provisionally registered.” The promoters were thereupon permitted to publish a prospectus, receive subscriptions to the company’s capital, and do a number of other acts incidental to its promotion. The subscribers to the capital then executed a “deed of settlement” containing such particulars about the company as are usually inserted in the incorporation paper; and when this deed of settlement was recorded the company was said to be “completely registered,” and was thenceforth a corporation. Companies which required a special act of parliament for their successful operation, such as railways, turnpikes, etc., were in the same way registered provisionally in anticipation of the passage of the desired special act. It seems to have been customary for the affairs of the company during the period of its provisional registration to be managed by a “provisional committee,”⁵ who, in turn, seem often to have delegated their active duties to a “committee of management.”⁶

§ 313. *Members of Provisional Association, Provisional Committees, etc., not Partners.* — From the foregoing sketch one readily perceives how much more formal such a preliminary

¹ *Bright v. Hutton*, 3 H. L. C. 341 (distinguishing *Hutton v. Upfill*, 2 H. L. C. 674). ⁵ See *Reynell v. Lewis*, 15 M. & W. 517; *Wilson v. Curzon*, 15 M. & W. 532.

² *Bright v. Hutton*, 3 H. L. C. 341. ⁶ See *Tanner’s Case*, 5 De G. & S.

³ *Hamilton v. Smith*, 5 Jur., N.S., 32. 182.

⁴ 7 & 8 Vict., c. 110, repealed by 19 & 20 Vict., c. 47, § 107.

organization was than anything serving a similar purpose with which Americans are in practice familiar. Nevertheless, it was held in England that neither the members of a company provisionally registered,¹ nor its provisional committeemen,² nor even the members of the innermost circle, the committee of management,³ were partners. This was true although such a provisionally registered company was so far an "association" as to be within the acts for the winding-up of companies and "associations."⁴ For instance, a provisionally registered company although, as just stated, held to be within the winding-up acts, could not be wound up by a court of equity as a partnership.⁵

§ 314. **Provisional Committees, etc., under other Statutes.**—The custom of promoting a projected corporation by means of provisional committees, etc., which originated in the Companies Act of 1844, seems to have to some degree survived in England the repeal of that statute; and we accordingly read occasionally of provisional committees and provisional directors of companies intended to be organized under the Act of 1862.⁶ A "provisional director" has been defined as one who is to be a director if the scheme succeeds and the company is incorporated.⁷ *A fortiori*, however, any such loose, informal association of the promoters or of the "provisional directors" which has no place in the scheme of the statute, and its still more informal American counter-part, cannot amount to a partnership.

§ 315. **Formation of Partnership between Promoters.**—Of course, no rule of law prevents the formation of a partnership for the purpose of promoting a corporation; and instances might be given where this in fact has been done.⁸ But to establish such

¹ *Walstab v. Spottiswode*, 15 M. & W. 501; *Ex parte Lloyd*, 1 Sim., N. S., 248. of contributories" in the winding-up of such "associations."

² *Reynell v. Lewis*, 15 M. & W. 517; *Norris v. Cottle*, 2 H. L. C. 647; *McEwan v. Campbell*, 2 Macq. H. L. 499.

³ *Burnside v. Dayrell*, 3 Ex. 224, 230.

⁴ *Bright v. Hutton*, 3 H. L. C. 341. Many of the English cases on the liabilities of promoters to third persons and *inter sese* have come up on the question whether or not a promoter should be placed on the "list

⁵ *Hamilton v. Smith*, 5 Jur., N. S., 32.

Cf. *Ward v. Brigham*, 127 Mass. 24.

⁶ *Maddick v. Marshall*, 17 C. B., N. S., 829.

⁷ *Burbidge v. Morris*, 3 H. & C. 664, 669, per Martin, B.

⁸ E. g. *Walker v. Anglo-American, etc. Co.*, 72 Hun (N. Y.) 334, 340; 25 N. Y. Supp. 432.

As to a "syndicate" as equivalent to a partnership in such matters, see *Hambleton v. Rhind*, 84 Md. 456; 36 Atl. 597; 40 L. R. A. 216.

a condition unusual circumstances must be shown, since the partnership relation cannot be inferred from the fact of co-operating as promoters.

§ 316. **Promotion by means of a Preliminary Corporation.** — As promoters may form a partnership to carry out their enterprise of organizing a company, so they may form a preliminary corporation for the same purpose;¹ but such cases are uncommon except where a very large company is forming. Of course, many corporations formed for the transaction of a general financial business, such as trust companies, frequently take part in the promotion of other corporations, but in such cases the trust companies are governed by the same rules of law as individual promoters.

§ 317-§ 349. RESPONSIBILITY OF CORPORATION FOR ACTS OF PROMOTERS.

§ 317-§ 319. *Responsibility for Acts done after Incorporation.*

§ 317. **In general.** — While, as we have seen,² a person may be a promoter of a company even after it has been incorporated, yet in respect to the power of promoters to bind the corporation by their acts and agreements, the law draws a sharp distinction between those acts which are done before, and those which are done after, the incorporation. After the company has acquired a corporate existence, the ordinary principles of the law of agency apply; and all that is necessary in order to make the company responsible for the torts or contracts of its promoters is to show that they were committed or made in the scope of their authority as agents. So, the liability of the company to pay for services rendered by the promoters after incorporation will depend entirely upon whether or not the understanding was that the promoters should receive compensation.³

¹ An instance may be found in *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392.

² *Supra*, § 310.

³ Cf. *Powell v. Georgia, etc. Ry. Co.*, 121 Ga. 803; 49 S. E. 759.

§ 318. **What is Date of Incorporation for this Purpose.** — The question may be raised, however, whether the technical date of incorporation — that is, under the common general incorporation laws, the date of the recording of the memorandum of association or incorporation paper — or the date of the first organization of the company for the transaction of business, is to be regarded as the crucial time within the meaning of this rule. Under the old system of incorporation by special act, where the corporation did not come into being until the act was accepted by the incorporators by organizing under it, this question could not so easily arise. But under the modern general laws where the corporation springs into existence immediately on registration without the necessity of any further acceptance or organization,¹ it may become very material. The argument may be urged, on the one hand, that while the company has from its registration a technical existence, yet it is still in a period of helpless infancy, and that not until it organizes for business does its career actually commence. On the other hand, it may be said, after the company's existence as a legal person begins, the technical objection that it cannot be bound by what occurred prior to its birth vanishes, and it would therefore seem that effect should be given even as against the corporation to contracts made with authority derived from the incorporators. This seems to be the law.² The mere execution of the incorporation paper before its registration does not, however, for this purpose, effect an incorporation.³

§ 319. **After Incorporation De Facto but not De Jure.** — Acquisition of a mere *de facto* corporate existence gives the company thenceforward a capacity to contract, and the same prin-

¹ *Glymont Improvement Co. v. Toler*, 80 Md. 278, 289; 30 Atl. 651, and *supra*, § 163.

² *Hall v. Vermont, etc. R. R. Co.*, 28 Vt. 401, 406-407; *Vermont Central R. R. Co. v. Claves*, 21 Vt. 30, 35-36; *Harrison v. Vermont Manganeese Co.*, 1 N. Y. Misc. 402; 20 N. Y. Supp. 894; *Legrand v. Manhattan Mercantile Ass.*, 80 N. Y. 638 (headnote inadequate); *Badger Paper Co. v. Rose*, 95 Wisc. 145; 70 N. W. 302; 37 L. R. A. 162.

See also *Kelner v. Baxter*, 2 C. P. 174; *Grape Sugar, etc. Co. v. Small*,

40 Md. 395; *Rathbone v. Tioga Nav. Co.*, 2 Watts & Serg. (Pa.) 74; *Low v. Connecticut, etc. R. R. Co.*, 45 N. H. 370.

But see *Ex parte Hanly*, 41 Ch. D. 215, 223-226, 237 (headnote inadequate); *Whelstone v. Crane Bros. Mfg. Co.*, 1 Kans. App. 320; 41 Pac. 211; *Gent v. Manufacturers, etc. Ins. Co.*, 107 Ill. 652; *McVicker v. Cone*, 21 Oreg. 353; 28 Pac. 76; *Aspen Water, etc. Co. v. Aspen*, 5 Colo. App. 12; 37 Pac. 728.

³ See cases cited *infra*, § 323.

ciples apply as if the incorporation had been *de jure*.¹ It has been said that where a *de facto* corporation becomes incorporated *de jure*, the legally organized corporation is liable for the debts of the irregularly incorporated company.² On the other hand, an estoppel resting upon the members of an unincorporated body to deny their own incorporation cannot bind a lawful corporation which they subsequently organize.³

§ 320—§ 349. *RESPONSIBILITY FOR ACTS DONE PRIOR TO INCORPORATION.*

§ 320. *In general.* — The responsibility of corporations for acts done by their promoters prior to incorporation has been the subject of contention in not a few legal battles. Of course, no one denies the power of promoters to bind the future company by moulding its constitution as expressed in the incorporation paper. This very power is the *raison d'être* of much that is peculiar in the law of promoters. But the question now in hand relates to their power to bind the intended company by transactions *dehors* the record.

§ 321. *Responsibility Ex Delicto.* — Probably no one has ever contended that the corporation should be liable in damages for torts committed by its promoters before it had any existence; and certainly no such contention could be maintained.⁴

§ 322—§ 346. *RESPONSIBILITY EX CONTRACTU.*

§ 322. *Subscriptions to Shares.* — With respect to contracts the case is not so simple. Subscriptions to shares of capital, it should be premised, differ in many respects from other contracts, and have therefore received separate consideration.⁵

¹ See *Bergen v. Porpoise Fishing Co.*, 41 N. J. Eq. 238; 3 Atl. 404; *Grand River Bridge Co. v. Rollins*, 13 Colo. 4; 21 Pac. 897.

² *Georgia Ice Co. v. Meakin*, 70 Ga. 637.

Cf. *Calumet Paper Co. v. Stotts Investment Co.*, 96 Iowa 147; 64 N. W. 782; 59 Am. St. Rep. 362.

³ *Bradley Fertilizer Co. v. South Publishing Co.*, 4 N. Y. Misc. 172, 23 N. Y. Supp. 675.

⁴ *Karberg's Case* (1892), 3 Ch. 1, 13.

See also *McCallum v. Pursell Mfg. Co.*, 1 N. Y. Supp. 428.

⁵ *Supra*, § 238—§ 260.

§ 323-§ 325. *Contracts other than Subscriptions to Shares.*

§ 323. **Rule at Law.** — The rule at law is very simple, and has commanded, it is believed, universal acceptance: no contract made by promoters on behalf of a corporation projected but not yet formed, can, *proprio vigore* and without any adoption or confirmation by the corporation, bind the company when incorporated,¹ unless by virtue of some express statute; and “this is so although the promoters become, at the creation of the corporation, its only stockholders, directors and officers.”² This rule is founded upon the basic principle that no one can be an agent for a person — the corporation — not yet in existence. Consequently, the rule clearly applies to all such contracts made at any time before the very moment of incorporation. Hence, it applies to a contract made subsequent to the execution of the memorandum of association or incorporation paper before its registration.³ Other questions as to the point of time which

¹ *Kelner v. Baxter*, 2 C. P. 174; *Payne v. New South Coal Co.*, 10 Ex. 283; *Gunn v. London, etc. Fire Ins. Co.*, 12 C. B., N. S., 694; *Franklin Fire Ins. Co. v. Hart*, 31 Md. 59; *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58, 75-76; 8 N. E. 355; *Western Screw, etc. Co. v. Consley*, 72 Ill. 531; *Buffington v. Bardon*, 80 Wisc. 635; 50 N. W. 776; *Long v. Citizens' Bank*, 8 Utah 104; 29 Pac. 878; *Carey v. Des Moines, etc. Mining Co.*, 81 Iowa 674; 47 N. W. 882; *Tift v. Quaker City Nat. Bank*, 141 Pa. St. 550; *Gent v. Manufacturers, etc. Ins. Co.*, 107 Ill. 652; *Battelle v. Northwestern Cement, etc. Co.*, 37 Minn. 89 (semble); 33 N. W. 327; *Weatherford, etc. Ry. Co. v. Granger*, 86 Tex. 350; 24 S. W. 795; 40 Am. St. Rep. 837; *Little Rock, etc. R. R. Co. v. Perry*, 37 Ark. 164, 192, 193 (rulings on plaintiff's first and defendant's second instruction); *Winters v. Hub Mining Co.*, 57 Fed. Rep. 287; *Adams v. Empire Laundry Machinery Co.*, 4 N. Y. Supp. 738; *Pittsburg, etc. Mining Co. v. Quintrell*, 91 Tenn. 693, 695, 696; 20 S. W. 248 (semble); *Bash v.*

Culver Gold Mining Co., 7 Wash. 122; 34 Pac. 462.

Cf. *Bluehill Academy v. Witham*, 13 Me. 403.

As to mechanics' liens, see *Davis v. Maysville Creamery Ass'n*, 63 Mo. App. 477; *McFall v. McKeesport, etc. Co.*, 123 Pa. St. 259; 16 Atl. 478; *Chicago Bldg. & Mfg. Co. v. Talbotton Creamery, etc. Co.*, 106 Ga. 84; 31 S. E. 809; *Davis v. Ravenna Creamery Co.*, 48 Nebr. 471 (head-note inadequate); 67 N. W. 436; *Coyote, etc. Co. v. Ruble*, 8 Oreg. 284; *Bank of Forrest v. Orgill Bros., etc. Co.*, 34 So. 325; 82 Miss. 81.

The liability of a corporation *quasi ex contractu* for benefits conferred upon it prior to its formation is discussed infra, § 338-§ 340.

² *Battelle v. Northern Cement, etc. Co.*, 37 Minn. 89, 90; 33 N. W. 327; *Scadden Flat, etc. Co. v. Scadden*, 121 Cal. 33; 53 Pac. 440 (semble).

But see *Paxton v. Bacon Mill, etc. Co.*, 2 Nev. 257; *Chicago Bldg. & Mfg. Co. v. Talbotton Creamery, etc. Co.*, 106 Ga. 84; 31 S. E. 809.

³ *Kelner v. Baxter*, 2 C. P. 174.

But see argument for appellee in

should be taken as the date of incorporation for the purpose of this rule have been considered above.¹

§ 324. **Rule in Equity.** — In equity more diversity of opinion has existed. In some comparatively early cases, the promoters of a special act of incorporation agreed with a third party, in consideration of his withdrawal of opposition to the passage of the act, that the company when incorporated should pay a sum of money or exercise its franchise in some particular way. Lord Cottenham held that the corporation, having necessarily received the benefit of the contract, and indeed owing its very existence thereto, might be enjoined from violating the terms of the agreement.² But the House of Lords subsequently held that at all events no such agreement could be enforced against the company unless the acts to be done thereunder by the corporation were within powers conferred in the act of incorporation;³ and the opinion was emphatically expressed that, even if they were, a court of equity would not enforce the contract against the company. Lord Cottenham's view was severely criticised,⁴ and the fallacy lurking in the notion that the existence of the corporation as an entity distinct from its corporators is a mere technicality was exposed. Upon incorporation new rights and interests arise; and subsequent shareholders have a right to insist that the corporation be not shackled from its very birth by burdens of which they cannot be supposed to have notice. Although, in a later case, it was said that such a contract by promoters might be specifically enforced by the corporation,⁵ which

Grape Sugar, etc. Co. v. Small, 40 Md. 395, 397-398. Cf. *supra*, § 133.

¹ *Supra*, § 318 and § 319.

² *Edwards v. Grand Junction Ry. Co.*, 1 Myl. & C. 650; *Stanley v. Chester, etc. Ry. Co.*, 3 Myl. & C. 773. Accord: *Earl of Lindsey v. Great Northern Ry. Co.*, 10 Hare 664.

See also *Gooday v. Colchester, etc. Ry. Co.*, 17 Beav. 132. Lord Cottenham's views were referred to with approval in *Low v. Connecticut, etc. R. R. Co.*, 45 N. H. 370, 375-376; *Little Rock, etc. Ry. Co. v. Perry*, 37 Ark. 164, 187 et seq.; *Cook v. Sterling Electric Co.*, 150 Fed. 766; 80

C. C. A. 502, is perhaps based on the same principle.

³ *Caledonian Ry. Co. v. Helensburgh*, 2 Macq. H. L. 391; *Preston v. Liverpool, etc. Ry. Co.*, 5 H. L. C. 605 (semble). Accord: *Earl of Shrewsbury v. North Staffordshire Ry. Co.*, 1 Eq. 593; *Leominster Canal Nav. Co. v. Shrewsbury, etc. Ry. Co.* 3 K. & J. 654, 668.

⁴ *Caledonian Ry. Co. v. Helensburgh*, 2 Macq. H. L. 391; *Preston v. Liverpool, etc. Ry. Co.*, 5 H. L. C. 605; *Earl of Shrewsbury v. North Staffordshire Ry. Co.*, 1 Eq. 593.

⁵ *Bedford, etc. Ry. Co. v. Stanley*, 2 Johns. & H. 746.

dictum, in view of the equitable requirement of mutuality as to the right to specific performance, would perhaps imply that the same remedy might have been invoked against the corporation, yet there can be little doubt that the views of the members of the House of Lords embody sound doctrine, and that in equity as at law a corporation is never bound, in the absence of some acquiescence or adoption, to abide by contracts made on its behalf before its creation.¹ For this reason, where property was settled in trust for a corporation to be thereafter organized, it was held that the company after its formation could compel the trustee to execute the trust in spite of its refusal to carry out an agreement made by the settlor of the trust, who was a promoter of the company, that the corporation should pay the trustee a certain compensation for his services.² The ground of the decision was that the contract of the promoter bound himself alone, and that the company could not be required to perform a contract by which it was not bound as a condition to the enforcement of a valid trust in its favor. So, an agreement between promoters that one of them shall own a sixth of the company's capital will not justify an injunction restraining the corporation from increasing its capital and thereby diminishing the proportionate interest of the last-mentioned promoter.³

§ 325. **Contracts by Existing Corporation in Anticipation of Extension of Powers distinguished.** — From the class of contracts considered in the last paragraph, one should carefully distinguish contracts made by an existing corporation in anticipation of an extension of its powers. If the powers are enlarged as expected, such contracts are binding even though they would have been *ultra vires* if the enlargement had not been had. Thus, where an existing railway company applied for an act of parliament to extend its powers by conferring authority to construct a branch line, an owner of land lying in the proposed new route

¹ *Re Rotherham Alum Co.*, 25 Ch. (Colo.), 86 Pac. 335; *Pennell v. D.* 103, 109 (headnote inadequate); *Lothrop*, 191 Mass. 357.

Natal Land, etc. Co. v. Pauline Colliery Syndicate (1904), A. C. 120; *But see Paxton v. Bacon Mill, etc. Co.*, 2 Nev. 257.

Munson v. Syracuse, etc. R. R. Co., 103 N. Y. 58, 75-76; 8 N. E. 355; ² *Hecla, etc. Mining Co. v. O'Neill*, 19 N. Y. Supp. 592.

Park v. Modern Woodmen of America, 181 Ill. 214, 232-234; 54 N. E. 932; *Miser Gold, etc. Co. v. Moody* ³ *Martin v. Remington-Martin Co.*, 95 N. Y. App. Div. 18; 88 N. Y. Supp. 573.

withdrew his opposition to the bill in consideration of the railway's agreement to purchase the land from him at a certain figure if the act should pass; and the House of Lords held that this contract would be specifically enforced in equity.¹ In such cases, the company after the amendatory act remains the same legal person as before, and there is therefore no question of enforcing against a corporation contracts made before it came into existence; the distinction is obvious.

§ 326. "Ratification" of Pre-incorporation Contract. — Contracts made on behalf of a company prior to its incorporation are obviously incapable of ratification by the company, if "ratification" be used with the ordinary meaning which it bears in the law of agency.² For, in order that a contract by one acting as agent should be ratified by the party on whose behalf it was made, the latter must have been in existence when the contract was made. Ratification, properly so called, must relate back to the time of the making of the contract. There can be no technical ratification of a contract made before the corporation had existence;³ and this is true not only at law but also in equity.⁴

¹ *Eastern Counties Ry. Co. v. Hawkes*, 5 H. L. C. 331 (headnote misleading).

Cf. *Great Western Ry. Co. v. Birmingham, etc. Ry. Co.*, 2 Phill. 597; *Goody v. Colchester, etc. Ry. Co.*, 17 Beav. 132; *Scottish N. E. Ry. Co. v. Stewart*, 3 Macq. H. L. 382; *Low v. Connecticut, etc. R. R. Co.*, 46 N. H. 284, 295.

² "Ratification" is often used in this connection as synonymous with "adoption"; *Schreyer v. Turner Flouring Mills Co.*, 29 Oreg. 1, 6; 43 Pac. 719; *Queen City, etc. Co. v. Crawford*, 127 Mo. 356; 30 S. W. 163.

See also *Wood v. Whelen*, 93 Ill. 153, 164-165; *Alexander v. Winters*, 23 Nev. 475, 485; 49 Pac. 116.

³ *Scott v. Lord Ebury*, 2 C. P. 255; *Re Dale & Plant*, 61 L. T. 206; *McArthur v. Times Printing Co.*, 48 Minn. 319; 51 N. W. 216; 31 Am. St. Rep. 653; *Stainsby v. Frazer's Metallic Life Boat Co.*, 3 Daly N. Y. 98; *Koppel v. Mass. Brick Co.*, 192 Mass. 223; 78 N. E. 128.

Contra: *Stanton v. New York, etc. Ry. Co.*, 59 Conn. 272; 22 Atl. 300; 21 Am. St. Rep. 110 (semble); *Whitney v. Wyman*, 101 U. S. 392.

Cf. *Dubuque Female College v. Township District*, 13 Iowa 555, 560-561.

⁴ *Re Empress Engineering Co.*, 16 Ch. D. 125; *Natal Land, etc. Co. v. Pauline Colliery Syndicate* (1904), A. C. 120; *Pennell v. Lothrop*, 191 Mass. 357.

§ 327-§ 337. *Adoption of Contract — New Contract on same Terms.*

§ 327. **In general.** — In many American cases it has been thought that the company may be rendered liable by *adoption* of the contract.¹ If “adoption” be used as synonymous with ratification,² it is open of course to the same objections; and if, as is generally the case, it is used in a different sense, it merely obscures the real nature of the transaction, which consists in the making of a new contract by the corporation. For, nice reasoning leads irresistibly to the conclusion that no merely unilateral act on the part of the company with reference to such a contract can establish contractual relations between the company and the third party. In order to effect that result, there must be mutual assent, a meeting of minds, between the corporation and the third party.³ In other words, there must be a new contract; and it is in the sense of the making of a new contract that “adoption” is generally used.⁴

§ 328. **English Rule.** — The making of a new contract is, then, the only logical and thoroughly satisfactory method of rendering such ante-incorporation contracts obligatory between the company and the third party; and the English cases carry this doctrine to the uttermost. Thus, it is held in England that adoption and confirmation by the deed of settlement or its modern equivalent, the memorandum of association, or by the articles of association, will not render the contract binding on the company;⁵ and this is so because the memorandum or

¹ E. g. *Schreyer v. Turner Flouring Mills Co.*, 29 Oreg. 1; 43 Pac. 719; *Colorado Land, etc. Co. v. Adams*, 5 Colo. App. 190; 37 Pac. 39; *Pittsburg, etc. Mining Co. v. Quintrell*, 91 Tenn. 693; 20 S. W. 248; *Thistle v. Jones*, 45 N. Y. Misc. 215; 92 N. Y. Supp. 113; *Robbins v. Bangor Ry., etc. Co.*, 62 Atl. 136; 100 Me. 496; 1 L. R. A., n. s., 963; and many other cases.

² Cf. *Pennell v. Lothrop*, 191 Mass. 357 (where it was said that the contract could not become binding on the corporation by adoption).

³ *Penn Match Co. v. Hapgood*, 141 Mass. 145, 148; 7 N. E. 22;

Natal Land, etc. Co. v. Pauline Colliery Syndicate (1904), A. C. 120.

⁴ “There can be no difference between its making a contract by adopting an agreement originally made in advance for it by promoters, and its making an entirely new contract.” *Battelle v. Northwestern Cement, etc. Co.*, 37 Minn. 89, 90; 33 N. W. 327; per Gilfillan, C. J.

See also *Little Rock, etc. Ry. Co. v. Perry*, 37 Ark. 164, 193 (ruling on defendant’s second instruction); *Wasser v. Western Land, etc. Co.*, 97 Minn. 460; 107 N. W. 160.

⁵ *Gunn v. London, etc. Fire Ins. Co.*, 12 C. B., n. s., 694 (deed of set-

articles cannot constitute a contract between the company and non-members.¹ It has also been held in England that confirmation by the directors is insufficient to bind the corporation to the contract.² But if this conclusion is to be supported, the result should certainly not be made to depend on a mere question of words — whether the directors use the word “confirm” or some term more appropriate to the making of a contract. A more satisfactory ground is that confirmation by the directors is a unilateral act to which the intended other party to the contract is not privy, and that therefore the meeting of minds essential to the formation of a new contract is lacking.

§ 329. **American Rule — Theory of Continuing Offer.** — On the other hand, when a person makes a contract with one who professes to act on behalf of a corporation to be thereafter formed, it would seem that here should be taken to be a continuing offer on his part to enter into a like contract with the company when incorporated.³ According to this view, any action on the company's part, communicated to the other party, evincing a desire to abide by the contract would amount to an acceptance of the offer, and therefore complete the formation of a new contract. This, it is believed, represents the law in most of the United States; and this is usually what is meant when it is said that a pre-incorporation contract may be adopted by the company so as to become binding on it. In England, however, as the cases cited in the last paragraph indicate, this theory of a continuing offer seems not to have met with approval; and accordingly in England a new offer and acceptance (both of which, however, may be implied rather than express) are necessary in order to bind the company. Right here lies the difference, and, it is believed, the only difference between the English and American law on this subject. In America, a unilateral act, namely, acceptance by the company of what is deemed to be

tlement); *Re Northumberland Ave. Hotel Co.*, 33 Ch. D. 16 (articles of association).

¹ *Eley v. Positive Life Ass. Co.*, 1 Ex. D. 20; *Browne v. La Trinidad*, 37 Ch. D. 1.

² *Re Dale & Plant*, 61 L. T. 206; *North Sydney Investment, etc. Co. v. Higgins* (1899), A. C. 263, 271 (semble).

³ *Pratt v. Oshkosh Match Co.*, 89 Wisc. 406; 62 N. W. 84; *Penn Match Co. v. Hapgood*, 141 Mass. 145, 148, 149; 7 N. E. 22 (semble); *Holyoke Envelope Co. v. U. S. Envelope Co.*, 182 Mass. 171; 65 N. E. 54 (semble).

an existing offer is enough: in England, there must be a new offer by the other party to the contract, and of that offer an acceptance by the company.

§ 330. **What is sufficient Evidence to establish Adoption, or Making of New Contract — In general.** — At all events, it is everywhere agreed that if the evidence is sufficient to establish a new contract the company is bound;¹ and whether or not the proof is sufficient for that purpose is a question of fact in each case, which in actions at law must be left to the jury, so that uniformity of decision could not be expected.²

§ 331. **Effect of Mistake of Law or Fact.** — It has been held in England in the matter of the Northumberland Avenue Hotel Company, that a new contract cannot be inferred from acts done by the company in the belief that the anterior agreement was binding upon it; for example, where under such mistaken belief the company assented to a modification in the terms of the old agreement, there was held to be no new contract.³ But this principle is of doubtful soundness; for while stronger evidence of intention would be required where the company was laboring under such a mistake, yet if a mutual intent on the part of the company and the stranger that the agreement should be carried out is clearly proved, it would seem to be immaterial how that intention came about, whether by mistake of law or otherwise. Accordingly, a tendency to distinguish the Northumberland Avenue Hotel Case is observable.⁴ But a Missouri court has

¹ *Re Dale & Plant*, 61 L. T. 206. Regarded as a new contract, the adoption of a promoters' agreement in order to be binding, must be supported by a consideration. Cf. *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439; *Holyoke Envelope Co. v. U. S. Envelope Co.*, 182 Mass. 171; 65 N. E. 54.

² See *Davis v. Hillsboro Creamery Co.*, 10 Ind. App. 42; 37 N. E. 549 (a case which goes very far in holding that "adoption" by the company had not been proved).

³ *Northumberland Ave. Hotel Co.*, 33 Ch. D. 16.

⁴ *Howard v. Patent Ivory Co.*, 38 Ch. D. 156.

Other cases in which the company

has been held bound are: *Touche v. Metropolitan Warehousing Co.*, 6 Ch. 671; *Spiller v. Paris Skating Rink Co.*, 7 Ch. D. 368; *Seymour v. Spring Forest, etc. Ass'n*, 144 N. Y. 333, 341; 39 N. E. 365; 26 L. R. A. 859; *Bomer v. Am. Spiral, etc. Co.*, 81 N. Y. 468; *Colorado Land, etc. Co. v. Adams*, 5 Colo. App. 190; 37 Pac. 39; *Reichwald v. Commercial Hotel Co.*, 106 Ill. 439; *Bruner v. Brown*, 139 Ind. 600, 602; 38 N. E. 318; *Dubuque Female College v. Township District*, 13 Iowa 555; *Davis v. Dexter Butter, etc. Co.*, 52 Kans. 693; 35 Pac. 776; *Bridgeport, etc. Ice Co. v. Meader*, 72 Fed. 115, 119-120; 18 C. C. A. 451; *McDonough v. Bank of Houston*, 34

held that the "adoption" of an ante-incorporation contract, or the making of a new one on the same terms, will not in general be binding unless made with knowledge of all material *facts*.¹ This decision as well as the Northumberland Avenue Case would seem to rest upon the unwarranted assumption that any circumstance which would vitiate a principal's ratification of unauthorized acts of his agent would vitiate the adoption by a corporation of a pre-incorporation contract or the making of a new contract on the same terms. This assumption overlooks the fact that a new contract is not necessarily voidable on account of mistake of law or fact which would vitiate a mere ratification.

§ 332. *Implied Adoption or Implied New Contract.* — Certainly, the "adoption" of a contract of the promoters, or, what is the same thing, the making of a new contract, need not be express but may be implied from circumstances, and no formality is required except such as would be requisite in an entirely new contract of a similar character. Thus, "if it could make an entirely new similar contract, without the use of its seal or without writing, or without formal action of its board of directors, it may also adopt an agreement assumed to be made for it in advance by promoters."² If the promoters employ an advertising agent for a year and the corporation when formed retains him in its service, that fact is sufficient evidence to warrant the jury in finding a new contract by the corporation for the same period and on the same terms.³ Mere failure to repudiate liability has been

Tex. 309; *Hoag v. Lamont*, 16 Abb. 327; *Bond v. Pike* (Minn.), 111 Pr., N. S. (N. Y.), 91; *Church v. N. W.* 916.

Church Cement Co., 75 Minn. 85, 92; 77 N. W. 548; *Kaeppler v. Redfield Creamery Co.*, 12 S. Dak. 483; 81 N. W. 907; *Ennis Cotton Oil Co. v. Burke*, 39 S. W. 966 (Tex.); *Pittsburg, etc. Mining Co. v. Quintrell*, 91 Tenn. 693; 20 S. W. 248; *Esper v. Miller*, 91 N. W. 613; 131 Mich. 334; *Selover v. Isle Harbor Land Co.*, 91 Minn. 451; 98 N. W. 344 (contract to issue stock in exchange for property); *Bond v. Pike* (Minn.), 111 N. W. 916.

¹ *Pitts v. Steele Mercantile Co.*, 75 Mo. App. 221, 231.

² *Battelle v. Northwestern Cement, etc. Co.*, 37 Minn. 89, 90; 33 N. W. Co., 104 N. Y. Supp. 988.

held insufficient evidence of "adoption."¹ It has been said that "whatever would amount to a ratification of the unauthorized acts of an agent would be sufficient evidence of the adoption of the contracts of a promoter;"² but the authorities generally hardly justify this sweeping assertion, which seems to involve the same confusion of ideas criticised in the last paragraph.

It is scarcely necessary to say that if the company confesses judgment in an action brought against it on the contract, it thereby adopts the agreement *in toto*.³

§ 333. *Retention of Benefits as Evidence of Adoption.* — The circumstance most often seized upon to prove an adoption of promoters' contracts is the retention by the company of the benefits of the contracts. And indeed the voluntary reception of the benefits of a promoters' contract is strong evidence to establish a contract by the corporation on the same terms, and ought in all ordinary cases to be conclusive, the company being estopped to deny its liability on a contract of which it has voluntarily received the benefits.⁴

It is well, however, to bear in mind the limits upon this doctrine. Thus, the Supreme Court of Texas speaking through Associate Justice Gaines said: "Now when it is said that when a corporation accepts the benefits of a contract made by its promoters, it takes it *cum onere*, it is important to understand distinctly what is meant. There is so far as this matter is concerned a radical difference between a promise made on behalf of the future corporation in the contract itself the benefits of which the corporation has accepted, and the promise in a previous contract to pay for services in procuring the latter to be made. This is well illustrated by the facts of the present case:

¹ *Tift v. Quaker City Nat. Bank*, 141 Pa. St. 550; 21 Atl. 660. *v. N. Y., etc. Land Co.*, 134 N. Y. 197, 211; 32 N. E. 27; *Frankfort*,

² *Arapahoe Investment Co. v. Platt*, 5 Colo. App. 515, 518; 39 Pac. 584. *etc. Turnpike Co. v. Churchill*, 6 T. B. Mon. (Ky.) 427; 17 Am.

³ *Williams v. St. George's Harbor Co.*, 2 De G. & J. 546. Dec. 159; *Davis v. Valley Electric Light Co.*, 61 N. Y. Supp. 580;

⁴ *Bomer v. American Spiral, etc. Co.*, 81 N. Y. 468; *Schreyer v. Turner Flouring Mills Co.*, 29 Oreg. 1; 43 Pac. 719; *Paxton Cattle Co. v. First Nat. Bank*, 21 Nebr. 621, 644-645; 33 N. W. 271; 59 Am. St. Rep. 852; *Davis v. Dexter Butter, etc. Co.*, 52 Kans. 693; 35 Pac. 776; *Rogers v. N. Y., etc. Land Co.*, 134 N. Y. 197, 211; 32 N. E. 27; *Frankfort, etc. Turnpike Co. v. Churchill*, 6 T. B. Mon. (Ky.) 427; 17 Am. Dec. 159; *Davis v. Valley Electric Light Co.*, 61 N. Y. Supp. 580; *Kaeppler v. Redfield Creamery Co.*, 12 S. Dak. 483; 81 N. W. 907; *Streator Independent Tel., etc. Co. v. Continental Tel. Const. Co.*, 217 Ill. 577; 75 N. E. 546; *Chilcott v. Washington, etc. Colonization Co.* (Wash.), 88 Pac. 113; *Possell v. Smith* (Colo.), 88 Pac. 1064.

Here a proposition was made on behalf of the company, by its promoters, that if a bonus should be subscribed and paid to it, it would build its road between certain points, and would carry coal at a certain stipulated rate. By accepting the bonus, the company became bound to fulfil the stipulations of the contract. That was the burden which it took with the benefit of the agreement. But it also appears that one of the promoters promised the plaintiff that if he would assist in procuring subscribers to the bonus, the company would pay him for his services. This was not part of the contract the benefits of which were taken by the defendant.”¹

Moreover, the implication of a contract on the part of the company from the retention of benefits will not arise where the acceptance of the benefits is without knowledge of the terms of the contract;² nor unless the original contract was made with the intent that the company should become bound.³ Furthermore, the corporation cannot be required to pay for legal expenses incurred for the drafting of its incorporation papers and by-laws merely because it used the papers so prepared;⁴ for in such cases the benefits of the contract enure to the company without any voluntary action on its part. So, too, where a license to use a patent is granted to P, the consideration being gauged by the profits of a company intended to be formed to work the patent, if P assigns his rights to a trustee for the projected company by which after its incorporation the contract between P and the trustee is adopted, the use of the patent by the company will be referable to the contract between it and P and will therefore furnish no ground to infer a contract between it and the original licensor.⁵ So, where goods are sold to a promoter, the use of the goods by the corporation in pursuance of a transfer from the promoter does not tend to prove the

¹ *Weatherford, etc. Ry. Co. v. Creamery, etc. Co.*, 73 Pac. 83; 67 Granger, 86 Tex. 350, 356; 24 S. W. Kans. 489. See also *infra*, § 344. 795; 40 Am. St. Rep. 837.

² *Jones v. Smith* (Tex.), 87 S. W. 210; *English & Colonial Produce Co.* (1906), 2 Ch. 435. Cf. *infra*,
Cf. also *Hecla, etc. Mining Co. v. O'Neill*, 19 N. Y. Supp. 592.

³ *Pitts v. Steele Mercantile Co.*, § 338-§ 340. 75 Mo. App. 221, 231.

⁴ *Bagot Pneumatic Tyre Co. v. Davis, etc. Co. v. Hillsboro Clipper Pneumatic Tyre Co.* (1902), Creamery Co., 10 Ind. App. 42; 1 Ch. 146.

37 N. E. 549; *Tryber v. Girard*

“adoption” by the company of the contract between the original vendor and the promoter.¹

§ 334. **Miscellaneous Illustrations of Principle that “Adoption” is really a New Contract.** — As the so-called “adoption” by a corporation of a contract made for it by its promoters is really the making of a new contract, the agreement is not within that provision of the Statute of Frauds respecting contracts not to be performed within one year if it is to be performed within a year from the date of its “adoption” by the company.² So, in pleading, it is not necessary to set out that the agreement was originally made by the promoters and adopted by the company; but it may be described as made by the corporation.³ Where the “adoption” is by parol, the correct form of action against the company is *assumpsit* although the original contract be under seal.⁴

The adoption of a contract made by promoters, being in legal effect a new contract, is voidable if any of the directors who took part in the “adoption” were individually interested in the contract.⁵ But the contract may, it has been held, be adopted on behalf of the company by the very promoter by whom prior to incorporation it was made.⁶

¹ *Koppel v. Mass. Brick Co.*, 192 Mass. 223; 78 N. E. 128.

² *McArthur v. Times Printing Co.*, 48 Minn. 319; 51 N. W. 216; 31 Am. St. Rep. 653.

³ *McArthur v. Times Printing Co.*, 48 Minn. 319, 322; 51 N. W. 216; 31 Am. St. Rep. 653 (semble).

But see *Paxton Cattle Co. v. First Nat. Bank*, 21 Nebr. 621; 33 N. W. 271; 59 Am. St. Rep. 852, where the plaintiff declared on a promissory note made by the promoters of the defendant company in its name before its incorporation, and was allowed to recover. It is submitted that the plaintiff should have counted on the promise of the corporation to pay the amount of the note which was to be implied from its retaining and using the property in payment for which the note was given. See *Scadden Flat, etc. Co. v. Scadden*, 121 Cal. 33; 53 Pac. 440.

⁴ *Swisshelm v. Swissvale Laundry Co.*, 95 Pa. St. 367.

But see *Wood v. Whelen*, 93 Ill. 153, 167 (where the facts showed an adoption by the corporation of the seal previously attached); *Wiley v. Borough of Towanda*, 26 Fed. 594.

⁵ *Munson v. Syracuse, etc. R. R. Co.*, 103 N. Y. 58, 63-64; 8 N. E. 355.

⁶ *Pratt v. Oshkosh Match Co.*, 89 Wisc. 406; 62 N. W. 84; *Oakes v. Cattaraugus Water Co.*, 143 N. Y. 430; 38 N. E. 461; 26 L. R. A. 544 (but see strong dissenting opinion of Gray, J.). It has been said that less evidence of adoption will suffice where the officers adopting the contract were also the promoters by whom it was made than where the officers and promoters are different persons. *Hall v. Herter Bros.*, 83 Hun 19, 22; 31 N. Y. Supp. 692; affirmed short, 157 N. Y. 694; 51 N. E. 1091.

§ 335. **Adoption of Ultra Vires Contract.** — Clearly, no “adoption” by a corporation of a contract made by promoters on its behalf prior to its incorporation can render the contract binding upon it, if the contract was one which the company had no power to enter into and which would have been *ultra vires* and unenforceable if made in the first instance by the company after incorporation.¹

§ 336. **Corporation adopting Lease liable as Original Lessee.** — The effect of “adoption” by the company of promoters’ contracts is well illustrated by *Van Schaick v. Third Ave. R. R. Co.*² There, a lease was made to S, who by a contemporaneous collateral agreement declared himself trustee for a certain voluntary association or for any company that might be organized to take its place. The formation of a corporation was then contemplated for this purpose, and shortly thereafter the defendant company was accordingly incorporated. This corporation, having adopted the lease, became liable in equity, so the New York Supreme Court held, to pay the rent reserved thereby as if it had been the original lessee, so that the liability could not be avoided by any assignment. In a very similar case, the Pennsylvania Supreme Court went even further, and held that the lessor could not collect the rent from the promoter in whose name as lessee the lease had been made, the corporation when organized having adopted the contract of lease;³ but this decision is contrary to what is submitted to be the sounder doctrine — viz., that a promoter who incurs liability on a contract is not discharged by the subsequent adoption of the contract by the company.⁴

§ 337. **Effect of Fraud of Promoters procuring Original Contract.** — Where the original contract was obtained by the fraud or other improper conduct of the promoters, the new contract, or contract by adoption, with the company is not necessarily tainted with the same infirmity.⁵ If, however, the company at the time of the “adoption” of the contract knows that the other party has been deceived by the promoters and is still

¹ *First Nat. Bank v. Church Federation*, 105 N. W. 578; 129 Iowa 268. ² *Heckman's Estate*, 172 Pa. St. 185; 33 Atl. 552.

³ *Van Schaick v. Third Ave. R. R. Co.*, 49 Barb. 409. ⁴ *Infra*, § 361. ⁵ See *Central Park Fire Ins. Co. v. Callaghan*, 41 Barb. 448.

laboring under a mistake, doubtless the defrauded party would be relieved, in equity at least, against the contract with the corporation. The question has most frequently arisen in the case of contracts of subscription to shares,¹ which are peculiar in some respects, so that one cannot be sure that the same principles would be applied to other contracts.

§ 338—§ 340. *Quasi-contractual Liability for Benefits received under a Contract which has not been Adopted.*

§ 338. **On Principle.** — It is often said that where the company has received the benefit of a promoter's contract, it should be estopped to repudiate its own liability thereunder. The voluntary reception of the benefits by the corporation goes a great way towards establishing a new contract, and, as already stated, ought generally to be conclusive.² But oftentimes the benefit enures to the company without any voluntary acceptance on its part, and in such cases on principle no estoppel seems possible. The liability there must be worked out, if at all, on some theory of quasi-contract. But if the general principles of that branch of the law be rigorously applied, recovery is not possible; for the benefits were voluntarily bestowed upon the company without any request on its part. On the other hand, the circumstances attending the formation of a corporation are in many respects so peculiar as perhaps to justify an exception to the general rules of quasi-contracts; and it would certainly seem that no harm could result from holding a corporation liable to pay a reasonable sum, equivalent to the benefit actually received by it, for necessary services rendered, or necessary expenses incurred, on its behalf prior to its incorporation. Upon this principle, it should be observed, the measure of recovery would not be the value of the promoter's services or the amount of his expenses but the extent of the benefit to the company.

§ 339. **The English Cases.** — The English cases decline to adopt any such doctrine, and clearly hold that no recovery can be had against a corporation for benefits conferred upon it or expenses incurred on its behalf prior to its formation; and this

¹ See *supra*, § 257.

² See *supra*, § 333.

is the rule both at law ¹ and in equity.² Somewhat difficult to reconcile with this principle are the cases holding that a promoter may recoup out of a claim of the company for his secret profits the amount which he has expended in promoting the company.³ These latter cases proceed upon the theory that the promoter is liable only for his net profits; but if such expenses are properly chargeable to the private pocket of the promoter and not to the company, then the former's net profit should be estimated without deducting such expenses. However, this apparent inconsistency seems not to have troubled the English courts.

§ 340. **The American Cases.** — In the United States, the English rule exempting a corporation from any quasi-contractual liability for preliminary expenses is adopted by some courts;⁴ but others recognize a quasi-contractual liability for necessary preliminary expenses to the extent of the benefits received, upon some such theory as that suggested in the preceding paragraph.⁵

¹ *Melhado v. Porto Allegre Ry. Co.*, 9 C. P. 503.

Ch.), 61 Atl. 721; *Wright v. St. Louis Sugar Co.* (Mich.), 109 N. W.

² *Re Rotherham Alum Co.*, 25 Ch. D. 1062.

D. 103 (overruling dictum in *Re Hereford Waggon Co.*, 2 Ch. D. 621); *English & Colonial Produce Co.* (1906), 2 Ch. 435.

As to whether a corporation which refuses to adopt a contract made with promoters is liable upon a *quantum meruit* for benefits conferred upon it in pursuance of that contract, see *Sullivan v. Detroit, etc. Ry. Co.* (Mich.) 64 L. R. A. 673; 135 Mich. 661; 98 N. W. 756; 106 Am. St. Rep. 403.

Cf. *Otto Electrical Mfg. Co.* (1906), 2 Ch. 390.

³ *Bagnall v. Carlton*, 6 Ch. D. 371; *Emma Silver Mining Co. v. Grant*, 11 Ch. D. 918; *Lydney, etc. Co. v. Bird*, 33 Ch. D. 85. See *infra*, § 382.

⁴ *Low v. Connecticut, etc. R. R. Co.*, 45 N. H. 370; *Grand River Bridge Co. v. Rollins*, 13 Colo. 4; 21 Pac. 897; *Morton v. Hamilton College*, 100 Ky. 281; 38 S. W. 1; 35 L. R. A. 275; *Grier v. Hazard*, 13 N. Y. Supp. 583; *Farmers' Bank of Vine Grove v. Smith*, 49 S. W. Rep. 810; 105 Ky. 816; 88 Am. St. Rep. 341; *Perry v. Little Rock, etc. Ry. Co.*, 44 Ark. 383 (semble); *Taussig v. St. Louis, etc. R. R. Co.*, 186 Mo. 269; 85 S. W. 378 (lawyer's fees for preparing certificate of incorporation).

⁵ *Rockford, etc. R. R. Co. v. Sage*, 65 Ill. 328; 16 Am. Rep. 587; *Hall v. Vermont, etc. R. R. Co.*, 28 Vt. 401, 406; *Weatherford, etc. Ry. Co. v. Granger*, 86 Tex. 350, 357; 24 S. W. 795; 40 Am. St. Rep. 837; *Marchand v. Loan & Pledge Ass'n*, 26 La. Ann. 389; *Tuttle v. George H. Tuttle Co.* (Me.), 64 Atl. 496.

See also *Bell's Gap R. R. Co. v. Christy*, 79 Pa. St. 54 (headnote misleading); *Schmidt v. Nelke Art Lithographing Co.*, 16 N. Y. Misc. 300; 37 N. Y. Supp. 1138; *Jones v. Smith* (Tex.), 87 S. W. 210.

Cf. *Porch v. Agnew Co.* (N. J.

But even according to these latter authorities, no liability exists unless the services or expenses were reasonably necessary to the organization of the company.¹ Where the English rule prevails, a promise by the company after its incorporation, and therefore after the services were rendered, to pay for them is *nudum pactum* and unenforceable.² The distinctively American rule, it is submitted, would nowhere be applied unless the services were rendered under a general understanding that they should be paid for by the company.³

§ 341. **Effect of Provision in Incorporation Paper directing Payment of Preliminary Expenses.** — If the memorandum or articles of association of an English company authorize or direct the payment of preliminary expenses out of the company's funds, the other party acquires no right of action against the corporation to enforce such payment; but the directors have power to pay if they choose.⁴

§ 342. **Voluntary Payment.** — If no such provision is contained in the memorandum or articles, it seems that in England such payment is without consideration and therefore *ultra vires*;⁵ but in Connecticut a promissory note given by a company on account of expenses preliminary to its incorporation was held to be enforceable.⁶ Where the memorandum or articles authorize the payment of a specified sum to a promoter for his labor in form-

¹ *Weatherford, etc. Ry. Co. v. Granger*, 86 Tex. 350; 24 S. W. 795; *Christy*, 79 Pa. St. 54; 21 Am. Rep. 39. 40 Am. St. Rep. 837.

² *New York, etc. R. R. Co. v. Ketchum*, 27 Conn. 170; *Tuttle v. George H. Tuttle Co.* (Me.), 64 Atl. 496.

³ *West Point Tel., etc. Co. v. Rose*, 76 Miss. 61; 23 So. 629.

Cf. *Savin v. Hoylake Ry. Co.*, L. R. 1 Ex. 9; *Hinkley v. Sac Oil, etc. Co.* (Iowa), 107 N. W. 629, 631.

By some courts it seems to have been thought that the corporation is liable if the benefits were conferred at the request of a majority of the promoters but not otherwise — a rule very difficult of application. *Clarke v. O. & S. W. R. R.*, 5 Nebr.

⁴ *Bank of Turkey v. Ottoman Co.*, 2 Eq. 366; *Melhado v. Porto Allegre Ry. Co.*, 9 C. P. 503. Cf. *Hawkeye Co. v. Bank*, 157 Fed. 253.

As to the right of a solicitor to apply sums paid him by the company to payment of his charges for preparing the incorporation papers, see *English & Colonial Produce Co.* (1906), 2 Ch. 435, 440–441 (head-note inadequate).

⁵ *Ex parte Pelly*, 21 Ch. D. 490.

⁶ *Smith v. New Hartford Water Co.*, 73 Conn. 626; 48 Atl. 754. Cf. *Bond v. Pike* (Minn.), 111

N. W. 916.

ing the corporation, the directors have authority to pay him that amount without requiring from him any itemized account,¹ or indeed even if the amount be excessive.² But where the authority given to the directors is simply in general terms to pay the expenses of the company's formation, they may not pay a lump sum for that purpose;³ and if the lump sum so paid be clearly in excess of the expenditures, it seems that the payment is *ultra vires* of the corporation.⁴

§ 343. **Effect of Statutes directing Payment.** — Sometimes statutes expressly direct the payment by corporations of the expenses preliminary to their formation; and in that case, a promoter may sue the company in an action of debt grounded on the statute for his labor and outlay in and about its incorporation.⁵ This statutory right does not extend, however, to a case where the promoter agrees with his co-promoters to render his services gratuitously; and the corporation may plead such agreement as an equitable defence to the action.⁶ But a promise by the promoter with certain of the subscribers to the capital of the company that they shall incur no liability if the scheme prove abortive does not prevent him from proceeding against the corporation under this statute; the only remedy of the shareholders is by an action against the promoter on his contract, which was really one of indemnity.⁷ Such statutes give no right of recourse against the company to a person who was employed by one of the promoters as clerk or otherwise, and that whether he be a servant or independent contractor.⁸ The effect of such statutes is to make the preliminary expenses a debt of the company and as such enforceable in the same way as other debts, for example, by *scire facias* against the shareholders, where such a proceeding for enforcement of debts of the company is authorized by law.⁹ Where a statute imposes upon the company a liability for certain

¹ *Crosky v. Bank of Wales*, 4 Giff. 253; *Low v. Connecticut, etc. R. R. Co.*, 45 N. H. 370, 380.

² *Anglo-Greek Steam Co.*, 2 Eq. 1, 7 (semble), per Lord Romilly. ⁶ *Savin v. Hoylake Ry. Co.*, L. R. 1 Ex. 9.

³ *Re Englefield Colliery Co.*, 8 Ch. D. 388. ⁷ *Re Brampton & Longtown Ry. Co.*, 10 Ch. 177.

⁴ *Mann v. Edinburgh Northern Tramways Co.* (1893), A. C. 69. ⁸ *Re Kent Tramways Co.*, 12 Ch. D. 312; *Ex parte Hanly*, 41 Ch. D.

⁵ *Tilson v. Warwick Gas Light Co.*, 4 B. & C. 962; *Carden v. General Cemetery Co.*, 5 Bing. N. C. 461. ⁹ *Clowes v. Brettell*, 11 M. & W. 215.

preliminary expenses, such as fees for registration of the incorporation paper, a solicitor who pays such charges is entitled to reimbursement from the company.¹

§ 344—§ 346. *Rule in Cases where Promoters when making Contract did not intend a Future Corporation to be bound.*

§ 344. **In general.** — In all the cases considered above, the promoters contemplated at the date of the contract the formation of a company, and intended that the latter should be bound. Different considerations apply where those who afterwards organized the company did not at the time of the contract intend that a prospective corporation should be bound — did not, so to speak, make the contract on behalf of a prospective corporation.² In an Alabama case, the members of a partnership contracted not to engage in selling plough-stocks or plough-blades. Subsequently, they formed a corporation, in which they themselves held nearly if not quite all the shares, to carry on that very business. The court held that this company was not bound by this contract of its promoters; and, therefore, could not be enjoined from selling plough-stocks and plough-blades, unless its formation were a mere fraud, to enable its promoters and members to evade their obligations.³ If fraud had existed, the corporation would have been liable, not because it was bound by the contract, but because its members would not be allowed in equity to work a fraud under cover of the corporate fiction.⁴ A corporation is a legal entity; but it must not commit torts or perpetrate frauds. Similarly, a court of equity will enjoin a corporation from infringing a patent the validity of which the chief promoter was estopped to deny, the company having been organized to enable him to perpetrate the fraud.⁵

¹ *English & Colonial Produce Co.* 87 Md. 400, 424; 40 Atl. 171; 67 (1906), 2 Ch. 435, 439. Am. St. Rep. 357; 40 L. R. A. 632.

² *Tryber v. Girard Creamery, etc.* Co., 73 Pac. 83; 67 Kans. 489.

Cf. *Grand Rapids Furniture Co. v. Grand Hotel, etc. Co.*, 70 Pac. 838; 72 Pac. 687; 11 Wyo. 128.

See also *supra*, § 330.

³ *Moore, etc. Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206; 6 So. 41; 13 Am. St. Rep. 23.

Cf. *Bagby & Rivers Co. v. Rivers*,

⁴ See *Higgins v. California Petroleum, etc. Co.*, 122 Cal. 373; 55 Pac. 155; *Higgins v. California Petroleum, etc. Co.*, 81 Pac. 1070; 147 Cal. 363; *First Nat. Bank v. Trebein*, 59 Oh. St. 316; 52 N. E. 834.

⁵ *Siemens-Halske Electric Co. v. Duncan Electric Mfg. Co.*, 142 Fed. 157; 73 C. C. A. 375.

§ 345. **Assumption of Contract by Company.** — A corporation may expressly agree to assume the burden of contracts which were made before its formation, but not on its behalf or with a view to its creation, just as any individual may for a consideration assume the indebtedness of another.¹ For instance, in the Alabama case stated in the last paragraph, it was held that the company might adopt, or assume the burden of, the contract not to sell plough-stocks or plough-blades.² The facts may be sufficient to establish a novation.³

§ 346. **Corporation formed to take over Business of a Firm.** — These principles have found their most frequent application in cases where a corporation, formed to take over a business previously carried on by a co-partnership, assumes the burden of the firm's debts and contracts.⁴ It is sometimes thought that

¹ See *Waterman's Appeal*, 26 Conn. 96.

Cf. *White v. Westport Cotton Mfg. Co.*, 1 Pick. (Mass.) 215 (headnote inadequate); 11 Am. Dec. 168; *North American, etc. Trust Co. v. Colonial, etc. Mortgage Co.*, 83 Fed. 796; 28 C. C. A. 88. In the following cases, assumption of the contract by the corporation was held not to have been proved. *Church v. Church Cement Co.*, 75 Minn. 85; 77 N. W. 548; *Minneapolis Trust Co. v. Clark*, 47 Minn. 108; 49 N. W. 386; *Austin v. Tecumseh Bank*, 49 Nebr. 412; 68 N. W. 628; 59 Am. St. Rep. 543; 35 L. R. A. 444.

² *Moore, etc. Hardware Co. v. Towers Hardware Co.*, 87 Ala. 206, 213; 6 So. 41; 13 Am. St. Rep. 23.

³ See *Louis Cook Mfg. Co. v. Randall*, 62 Iowa 244; 17 N. W. 507; *Whitwell v. Warner*, 20 Vt. 425, 443; *Snow v. Thompson Oil Co.*, 59 Pa. St. 209.

⁴ In the following cases, an assumption by the corporation of the firm indebtedness was held to have been proved. *Waterman's Appeal*, 26 Conn. 96; *Burke v. Lincoln-Valentine Co.*, 28 N. Y. Misc. 202; 58 N. Y. Supp. 1077, 1124; *Hall v. Herter Bros.*, 83 Hun 19; 31 N. Y.

Supp. 692; 90 Hun 280; 35 N. Y. Supp. 769; 157 N. Y. 694; 51 N. E. 1091; *Reed Bros. Co. v. First Nat. Bank*, 46 Nebr. 168; 64 N. W. 701; *Johnston v. Grumble*, 19 So. Rep. 100 (Miss.); *Bremen Savings Bank v. Branch-Crookes Saw Co.*, 104 Mo. 425; 16 S. W. 209; *Lamkin v. Baldwin, etc. Co.*, 72 Conn. 57; 43 Atl. 593, 1042; 44 L. R. A. 786; *Williams v. Colby*, 6 N. Y. Supp. 459; 53 Hun 637; *Andres v. Morgan*, 62 Ohio St. 236; 56 N. E. 875; 78 Am. St. Rep. 712; *Schufeldt v. Smith*, 139 Mo. 367; 40 S. W. 887; *Lemars Shoe Co. v. Lemars Shoe Mfg. Co.*, 89 Ill. App. 245, 254-255 (voluntary payment by corporation held not *ultra vires*); *Quee Drug Co. v. Plaut*, 55 N. Y. App. Div. 87; 67 N. Y. Supp. 10.

See also *Haslett v. Wotherspoon*, 2 Rich. Eq. (S. Car.) 395; *Louis Cook Mfg. Co. v. Randall*, 62 Iowa 244; 17 N. W. 507; *Calumet Paper Co. v. Stotts Investment Co.*, 96 Iowa 147; 64 N. W. 782; 59 Am. St. Rep. 362.

In the following cases an assumption by the corporation was held not to have been proved. *Durlacher v. Frazer*, 8 Wyo. 59; 55 Pac. 306; 80 Am. St. Rep. 918; *White v. Westport Cotton Mfg. Co.*, 1 Pick. 215; 11 Am. Dec. 168; *Mc-*

where a firm transfers all its assets to a corporation in which the former partners own all the shares, the corporation becomes liable for the debts of the firm without any express or implied assumption thereof;¹ but this notion rests on the unfounded belief that in no other way can the firm creditors be protected. That such belief is without foundation is evident. For if the transfer of the partnership property to the corporation hinders or delays the firm creditors, they may treat the transfer as a fraudulent conveyance, and subject the property to payment of their claims in the hands of the corporation as a fraudulent grantee.² This remedy is ample; and, therefore, to hold the corporation liable as debtor in the firm's stead without any voluntary assumption by it of that position would be a gratuitous violation of legal principle, and has not met with general favor.³ Where, however, the cor-

Lellan v. Detroit File Works, 56 Mich. 579; 23 N. W. 321; *Dingeldein v. Third Ave. R. R. Co.*, 9 Bosw. (N. Y.) 79; *Ruby Chief, etc. Co. v. Gurley*, 17 Colo. 199, 202; 29 Pac. 668; *Hand v. Evans Marble Co.*, 88 Md. 226; 40 Atl. 899 (where recovery was denied on the ground of lack of privity between the plaintiff and the corporation); *Culberson v. Ala. Const. Co. (Ga.)*, 56 S. E. 765.

Cf. *Bradley Fertilizer Co. v. South Publishing Co.*, 17 N. Y. Supp. 587.

As to the bearing of the statute of frauds on such transactions, see *Georgia Co. v. Castleberry*, 43 Ga. 187; *Schufeldt v. Smith*, 139 Mo. 367, 377; 40 S. W. 887; *Waterman's Appeal*, 26 Conn. 96, 109; *Calumet Paper Co. v. Stotts Investment Co.*, 96 Iowa 147; 64 N. W. 782; 59 Am. St. Rep. 362.

As to the conversion of a firm into a corporation in pursuance of a provision in the partnership articles, see *Hennessy v. Griggs*, 1 N. Dak. 52; 44 N. W. 1010.

¹ Cf. *Baker Furniture Co. v. Hall* (Nebr.), 107 N. W. 117 (reversed on re-hearing in 111 N. W. 129); *Du Vivier v. Gallice*, 149 Fed. 118; 80 C. C. A. 556 (where the corporation

having expressly assumed all debts shown on the books of the partnership was held liable for a debt not so shown).

² *Bank v. Hollingsworth*, 135 N. Car. 556; 47 S. E. 618 (semble); *Colorado Trading, etc. Co. v. Acres Commission Co. (Colo.)*, 70 Pac. 954; 18 Colo. App. 253.

Cf. *Shumaker v. Davidson*, 87 N. W. 441; 116 Iowa 569; *Bristol, etc. Trust Co. v. Jonesboro, etc. Trust Co.*, 101 Tenn. 545; 48 S. W. 228 (similarity between name of corporation and name of firm not sufficient to establish fraud in law where no fraud in fact intended); *Thorpe v. Pennock Mercantile Co. (Minn.)*, 108 N. W. 940; *First Nat. Bank v. Trebein*, 59 Ohio St. 316; 52 N. E. 834. See also *infra*, § 1089.

³ *McLellan v. Detroit File Works*, 56 Mich. 579; 23 N. W. 321 (where the members of the corporation were the members of the firm); *Georgia Co. v. Castleberry*, 43 Ga. 187; *Hand v. Evans Marble Co.*, 88 Md. 226; 40 Atl. 899; *Bank v. Hollingsworth*, 135 N. Car. 556; 47 S. E. 618; *Culberson v. Ala. Const. Co. (Ga.)*, 56 S. E. 765; *Baker Furniture Co. v. Hall* (Nebr.), 111 N. W. 129.

poration was composed chiefly or entirely of the members of the firm and has taken a transfer of all its assets, an intention on the corporation's part to assume the firm indebtedness may be the more readily implied; less evidence of an actual intention to assume such burden is required than where the corporation is composed of strangers. It has been held that creditors of a corporation whose claims arose in the course of its business are entitled to a preference in respect to the corporate assets over partnership creditors whose claims the corporation has assumed;¹ but the contrary view has at least equal support, and is, it is submitted, preferable.² Where the firm is indebted to one of the partners, by way of compensation for sums drawn out by the other partners, such indebtedness upon its assumption by the corporation does not become a lien on the property transferred by the firm to the corporation, but the creditor partner becomes merely a general creditor of the corporation.³

§ 347. Appointment of Agents for Future Corporation. — As promoters cannot bind the future corporation by contract, so neither can they bestow on others any authority to contract on the company's behalf; and if they purport to do so, the attempt is wholly nugatory, and remains so even after the corporation is formed, unless their acts be confirmed by the directors or other competent authority. Hence, a mortgage executed by the company's officers in pursuance of an authority attempted to be conferred by the promoters prior to incorporation is not binding on the company.⁴ It would perhaps be otherwise if the authority were conferred by the incorporation paper; for as already stated, promoters have unquestionable power to bind the future corporation by shaping its constitution. Thus, the directors named in the incorporation paper have the same power as other directors.⁵

¹ *Lamkin v. Baldwin, etc. Co.*, 72 Conn. 57; 42 Atl. 593, 1042; 44 L. R. A. 786. ² *Francklyn v. Sprague*, 121 U. S. 215; 7 Sup. Ct. 951.

³ *Blood v. La Serena, etc. Co.*, 113 Cal. 221; 41 Pac. 1017; 45 Pac. 252. Cf. *Thorpe v. Pennock Mercantile Co.* (Minn.), 108 N. W. 940.

⁴ *Schufeldt v. Smith*, 139 Mo. 367; 40 S. W. 887; *London v. Bynum*, 136 N. Car. 411; 48 S. E. 764. ⁵ *Supra*, § 168.

§ 348. **Whether Knowledge of Promoters imputable to Corporation.** — As promoters are not prior to incorporation agents of the company or capable of binding it, their knowledge of an outstanding equity against property to be transferred to the corporation is not imputable to the latter, and will not deprive it of the rights of a *bona fide* purchaser.¹ But this doctrine cannot be used as a cover for fraud, for the protection of parties who organize themselves into a corporation to escape from a trust to which they are subject.² Indeed, cases of this latter sort may be supported on the ground that the company is affected with notice, not of what its promoters knew before its organization, but of what its members and officers knew after its formation when it acquired title to the property.

§ 349. **Admissions of Promoters.** — Admissions of promoters made prior to incorporation are not evidence against the company.³

§ 350-§ 356. **RIGHT OF CORPORATION TO THE BENEFIT OF ACTS OF PROMOTERS.**

§ 350. **Suits on Contracts made prior to Incorporation.** — The right of a corporation to sue on a contract made on its behalf prior to incorporation depends in general upon the same prin-

¹ *Davis, etc. Wheel Co. v. Davis, etc. Wagon Co.*, 20 Fed. 699; *Burt v. Batavia Paper Mfg. Co.*, 86 Ill. 66; *Mercantile Nat. Bank v. Parsons*, 54 Minn. 56; 55 N. W. 825; 40 Am. St. Rep. 299; *Grand Rapids Furniture Co. v. Grand Hotel, etc. Co.*, 70 Pac. 838; 72 Pac. 687; 11 Wyo. 128.

Cf. *Brennan v. Emery-Bird-Thayer Dry Goods Co.*, 99 Fed. 971; *Mercantile Nat. Bank v. Parsons*, 54 Minn. 56, 65; 55 N. W. 825; 40 Am. St. Rep. 299 (where the court said that notice to some of the corporators would not be imputed to the company but that notice to all of them would be).

But see *Oregon, etc. Nav. Co. v. Balfour*, 90 Fed. 295, 300; 33 C. C. A. 57; *Zeigler v. Valley Coal Co.* (Mich.), 113 N. W. 775.

² *National Conduit Co. v. Connecticut Pipe Mfg. Co.*, 73 Fed. Rep. 491, 495; *Holloway & McRaney v. Brame*, 36 So. 1; 83 Miss. 335; *Re Slobodinsky* (1903), 2 K. B. 517; *Carter v. Gray* (Ark.), 96 S. W. 377; *Cumberland Coal Co. v. Sherman*, 30 Barb. (N. Y.) 553; *Hoffman Coal Co. v. Cumberland, etc. Co.*, 16 Md. 456; 77 Am. Dec. 311.

Cf. *Young Reversible Lock-Nut Co. v. Young Lock-Nut Co.*, 72 Fed. Rep. 62, 65-66; *McElwee Mfg. Co. v. Trowbridge*, 62 Hun 471; 17 N. Y. Supp. 3; *Texas Loan Agency v. Hunter*, 13 Tex. Civ. App. 402, 409; 35 S. W. 399; *California Consolidated Mining Co. v. Manley*, 81 Pac. 50; 10 Idaho, 786; *McCourt v. Singers-Bigger*, 145 Fed. 103.

³ *McCallum v. Pursell Mfg. Co.*, 1 N. Y. Supp. 428; *Horowitz v.*

ciples as govern its liability on such contracts. Unless both are bound, neither is bound, is the rule in such cases.¹ But in jurisdictions where a stranger to a contract of which he is a beneficiary is allowed to sue thereon, a corporation may sometimes sue as a beneficiary of contracts entered into with its promoters before its incorporation. Moreover, a corporation may clearly become entitled by assignment to sue on such contracts,² or by novation, the company may become the obligee.³ Moreover, express statutes sometimes enable corporations to enforce contracts made on their behalf prior to incorporation.⁴

§ 351-§ 354. *Conveyances made for Company's Benefit prior to Incorporation.*

§ 351. **In general.** — The right of a company to avail itself of conveyances of property made for its benefit stands on a wholly different footing. For in the nature of things, there is no reason why a corporation when formed should not be entitled to the benefit of unilateral conveyances — e. g., by deed poll — which require no execution, or contemporaneous assent, by the grantee. As soon as the company is formed the previous conveyance should enure to its benefit, although possibly the transfer might in the meantime be revocable by the grantor. In the case of real property, the feudal principle invalidating conveyances of freehold interests to take effect *in futuro* would have constituted an insuperable obstacle at common law; for obviously

Broads Mfg. Co., 104 N. Y. Supp. 988.

Cf. *First Nat. Bank v. Armstrong*, 42 Fed. 193.

¹ *Penn Match Co. v. Hapgood*, 141 Mass. 145; 7 N. E. 22. For cases in which corporations sought in vain to enforce agreements made by their promoters, see *Ireland v. Globe Milling, etc. Co.*, 20 R. I. 190; 38 Atl. 116; *Flanagan v. Lyon*, 105 N. Y. Supp. 1049; 54 N. Y. Misc. 372 (holding that the corporation cannot sue for breach of an agreement among promoters *inter sese* whereby they promised that upon receiving from the corporation stock in exchange for prop-

erty to be turned over to it, they would return some of the shares to the company as treasury stock).

Cf. *Wiley v. Borough of Towanda*, 26 Fed. 594.

² Cf. *Syracuse, etc. R. R. Co. v. Gere*, 4 Hun (N. Y.), 392.

³ Cf. *Valk v. Crandall*, 1 Sandf. Ch. (N. Y.) 179, 182; *Re Thomas*, 14 Q. B. D. 379 (where the original contract was illegal and void but where the new contract with the corporation was valid).

⁴ See *Cumberland Land Co. v. Daniel* (Tenn.), 52 S. W. 446, applying Tenn. Acts, 1875, Chap. 142, § 29.

there could be no conveyance *in presenti* to a non-existent person. But since the Statute of Uses, a conveyance of land may be made to take effect *in futuro* as a springing use, and such a springing use may be raised in favor of a corporation formed after the execution of the deed; and a similar limitation in a will may be effective as an executory devise.¹ So, conveyances to charitable and pious uses may be made to remain in abeyance until the incorporation of the grantee, after which they become operative.² The notion, therefore, which must be admitted to be to some extent prevalent, that a corporation when organized cannot take advantage of conveyances made in its favor before its organization, would seem not to represent the law.³ A lease, or other bilateral conveyance, requiring execution both by grantor and grantee, stands on a different footing.⁴

§ 352. **Trusts for Future Corporation.** — *A fortiori*, property may be settled in trust for a corporation to be thereafter formed, and this trust may be enforced in chancery upon the ordinary principles of equity by the company, when organized,

¹ *Inglis v. Trustees of Sailors' Snug Harbour*, 3 Pet. 99, 115-116.

² *Town of Pawlet v. Clark*, 9 Cranch 292.

Cf. *Fadness v. Baunberg*, 73 Wisc. 257; 41 N. W. 84.

See Gray on Perpetuities, 2d ed., §§ 607 et seq.

³ *Dyer v. Rich*, 1 Metc. (Mass.) 180, 190; *Rotch's Wharf Co. v. Judd*, 108 Mass. 224; *American Silk Works v. Sclomon*, 4 Hun 135; *Bank v. Lumber Co.*, 32 W. Va. 357; 9 S. E. 243; 3 L. R. A. 583; *Sumter Tobacco Warehouse Co. v. Phoenix Ins. Co.* (S. Car.), 56 S. E. 654 (headnote inadequate).

Cf. *Sayward v. Gardner*, 5 Wash. 247, 256; 31 Pac. 761; 33 Pac. 389; *Rathbone v. Tioga Nav. Co.*, 2 Watts & Serg. (Pa.) 74, 78-79; *African M. E. Church v. Conover*, 27 N. J. Eq. 157; *Cumberland Land Co. v. Daniel* (Tenn.), 52 S. W. 446 (decided under a statute which was construed to entitle the corporation to the benefit of the conveyance); *Mt. Carmel Tel. Co. v. Mt. Carmel & Fleming*

Tel. Co. (Ky), 84 S. W. 515 (holding that where a majority of the subscribers to stock of a projected corporation refuse to accept the incorporation paper drawn up by a committee and organize a corporation under a different incorporation paper, the latter corporation rather than that organized by the committee is entitled to property acquired by the promoters).

But see *Aspen Water, etc. Co. v. Aspen*, 5 Colo. App. 12; 37 Pac. 728; *Jones v. Aspen Hardware Co.*, 21 Colo. 263; 40 Pac. 457; 52 Am. St. Rep. 220; 29 L. R. A. 143; *Broadwell v. Merritt*, 87 Mo. 95 (conveyance upheld, but on ground of estoppel); *Dunning v. Bates*, 186 Mass. 123; 71 N. E. 309 (notice, however, the well-reasoned dissenting opinion).

See also cases cited supra, § 294.

⁴ *Utah Optical Co. v. Keith*, 18 Utah 464; 56 Pac. 155.

Cf. *Thistle v. Jones*, 45 N. Y. Misc. 215; 92 N. Y. Supp. 113.

as *cestui que trust*.¹ So, money paid to a promoter by way of deposits or earnest upon subscriptions to shares may be recovered by the company when incorporated as money had and received to its use.²

§ 353. **Cases distinguished.** — On the other hand, a conveyance or a devise which is made to an unincorporated association as an existing entity and which is incapable of taking effect because the grantee is not incorporated cannot be availed of by a corporation which is subsequently formed as the successor of the unincorporated body.³ As explained elsewhere, such a conveyance will either vest title in the members of the supposed corporation or voluntary association as tenants in common, or else it will be void for indefiniteness.⁴ Moreover, a deed to certain persons as “incorporators” will not without any assignment from them vest title in a corporation which they subsequently organize.⁵

§ 354. **Property acquired by Promoters in Course of Promotion.** — As will presently be more fully explained, promoters will not be allowed to hold for their own benefit property acquired by them on behalf of the company which they were engaged in organizing, and will therefore be required by a court of equity to execute an assignment of such property to the company.⁶

§ 355. **Assignments from Promoters to Company — Taking over Property of a Firm.** — Of course, a company after its incorporation may take an assignment from its promoters,⁷ or indeed from any other persons, of any property they may own; and in

¹ *Hecla Consolidated, etc. Co. v. O'Neill*, 19 N. Y. Supp. 592; *African M. E. Church v. Conover*, 27 N. J. Eq. 157; *McCandless v. Inland Acid Co.*, 42 S. E. 449; 115 Ga. 968.

Cf. *Van Schaick v. Third Ave. R. R. Co.*, 49 Barb. 409; *Church of St. Stanislaus v. Allgemeine Verein*, 31 N. Y. App. Div. 133; 52 N. Y. Supp. 922; affirmed short, 164 N. Y. 606; 58 N. E. 1086.

² *San Joaquin, etc. Co. v. West*, 94 Cal. 399; 29 Pac. 785. See also *supra*, § 255, and *infra*, § 399.

³ *State use M. E. Church v. Warren*, 28 Md. 338. Cf. *Douthitt v. Stinson*, 63 Mo. 268. In the case of charities, the object of the deed or will may be effectuated in some states by the doctrine of *cy pres*.

⁴ *Supra*, § 294.

⁵ *McCandless v. Inland Acid Co.*, 112 Ga. 291; 37 S. E. 419.

⁶ *Seacoast R. R. Co. v. Wood*, 56 Atl. 337; 65 N. J. Eq. 530.

See *infra*, § 399.

⁷ Cf. *Alexander v. Tolleston Club*, 110 Ill. 65 (holding that a lease to a

some cases such an assignment from the promoters to the company will be presumed, or regarded as implied.¹ Thus, where a company was formed for the express purpose of operating a street railway franchise recently acquired by the promoters, a formal transfer of the franchise to the company has been thought unnecessary.² So, where a corporation is formed by special act to manage and dispose of certain real estate formerly held by the incorporators in common, the terms of the act may be such as, upon its acceptance, to transfer the legal title to the company.³ But these cases must be deemed exceptional; for ordinarily when a partnership or other voluntary association becomes incorporated, that mere fact does not invest the corporation with title to the property of the voluntary association; and this is true whether the incorporation is effected by special act,⁴ or under a general law.⁵

§ 356. **Survey for Railway made before Incorporation.** — A survey for a railway made by promoters may be availed of by the company after incorporation without making a new survey, so as to constitute compliance with a statute requiring the loca-

club which is unincorporated but is about to become incorporated "for and during the existence of said club" is not terminated by the incorporation of the club, accompanied by a transfer of all its property to the corporation).

¹ See *Thistle v. Jones*, 45 N. Y. Misc. 215; 92 N. Y. Supp. 113.

As to the application of the Statute of Frauds to such an assignment, see *Roth Tool Co. v. Champ-Spring Co.*, 93 Mo. App. 530; 67 S. W. 967 (headnote inadequate).

² *Santa Rosa R. R. v. Central Street Ry. Co.*, 38 Pac. Rep. 986, 989 (Cal.).

Cf. *Spring Valley Water Works v. San Francisco*, 22 Cal. 434, 442.

³ *Colquitt v. Howard*, 11 Ga. 556.

Cf. *African M. E. Church v. Conover*, 27 N. J. Eq. 157; *Scots Charitable Soc. v. Shaw*, 8 Mass. 532.

⁴ *Holland v. Cruft*, 3 Gray 162; *Leffingwell v. Elliott*, 8 Pick. 455; 19 Am. Dec. 343; *Frank v. Drenkhahn*, 76 Mo. 508; *McLeary v.*

Dawson, 87 Tex. 524; 29 S. W. 1044; *Mears v. Moulton*, 30 Md. 142 (headnote inadequate); *Catholic Church v. Tobben*, 82 Mo. 418.

⁵ *Manahan v. Varnum*, 11 Gray, 405; *Rau v. Union Paper Mill Co.*, 95 Ga. 208; 22 S. E. 146; *McCandless v. Inland Acid Co.*, 112 Ga. 291; 37 S. E. 419; *Ruettell v. Greenwich Ins. Co. (N. Dak.)*, 113 N. W. 1029.

But see *Church of St. Stanislaus v. Allgemeine Verein*, 31 N. Y. App. Div. 133; 52 N. Y. Supp. 922, affirmed short in 164 N. Y. 606; 58 N. E. 1086; *American Silk Works v. Salomon*, 6 T. & C. (N. Y.) 352; *White Oak Grove Benev. Soc. v. Murray*, 145 Mo. 622; 47 S. W. 501.

Cf. *Re Cussons*, 73 L. J. Ch. 296 (where, by virtue of certain provisions in the Companies Act of 1862, the incorporation of a firm under the statute was held to invest the corporation with equitable but not legal title to the firm real estate).

tion of the company's route by survey in order to give a right of condemnation;¹ but on the other hand it has been held that such an adoption of the survey without actually taking possession of the land will not give any prior right as against another company which takes actual possession by retracing the line as its own.²

§ 357-§ 362. *LIABILITIES OF PROMOTERS TO PERSONS NOT CONNECTED WITH THE COMPANY.*

§ 357-§ 361. *CONTRACTUAL LIABILITY.*

§ 357. *After Incorporation.* — The contractual liabilities of promoters to persons other than the corporation are controlled after its formation by the ordinary principles of the law of agency. That is to say, if the promoter contracts avowedly as agent for an already incorporated company, he is not personally liable unless authority to act for the corporation is lacking. On the other hand, if he does not disclose his agency or his principal, he is personally liable on the contract. Whether the date of technical incorporation or of organization for business is to be deemed the point from which these ordinary principles of agency come into play depends upon the same considerations weighed above in respect to the similar and indeed identical question as to when the company becomes capable of being bound by contracts entered into on its behalf.³ The embryonic condition of the corporation, even though it has attained a technical existence, may be a circumstance tending to show that credit was given to the promoters individually rather than to the corporation.⁴ If the corporation is formed to take over the business of a firm, customers of the firm who have no notice of the change may, upon familiar principles of the law of partnership, continue to look for payment to the members of the firm, who will be es-

¹ *Chesapeake, etc. Ry. Co. v. Deep- Pittsburgh, etc. R. R. Co.*, 105 Pa. water Ry. Co., 50 S. E. 890; 57 St. 13. W. Va. 641.

² *Supra*, § 318.

Cf. Milwaukee Light, Heat & Traction Co. (Wisc.), 112 N. W. 663. 725, 731.

⁴ *Ijams v. Andrews*, 151 Fed.

³ *New Brighton, etc. R. R. Co. v.*

topped from denying their liability for debts contracted after incorporation.¹

§ 358-§ 361. *Before Incorporation.*

§ 358. **In general.** — Before incorporation, promoters who contract without disclosing that they are not acting on their own account are of course liable personally just as agents for an undisclosed principal would be liable; and even if they contract expressly on behalf of the company, they cannot shield themselves under the rule which protects an authorized agent for a named principal, since the corporation not being in existence, they cannot be authorized to bind it. On the contrary, having contracted for a non-existent principal, they are liable on their implied warranty of authority unless they disclosed that their supposed principal was not then incorporated. In most cases such disclosure is made, so that no implied warranty of authority is broken.² If the disclosure be made, no liability is incurred unless the promoter and the third party mutually intended to contract on the footing of the former's personal liability; and it is a question of fact for the jury whether such was the intention.³ If the contract is in writing, so that its construction is for the court, in the absence of anything in the document itself indicative of a different intention, it will be construed as imposing a personal liability on the promoter, since otherwise, the corporation not being in existence, it would have no binding effect whatever;⁴ and parol evidence in such a case is not admissible to show an

¹ *Perkins v. Rouss*, 29 So. 92; 78 Miss. 343; *Martin v. Fewell*, 79 Mo. 401, 412; *Henry v. Simanton*, 54 Atl. 153; 64 N. J. Eq. 572.

² See *Hersey v. Tully*, 8 Colo. App. 110, 112; 44 Pac. 854.

³ *Higgins v. Hopkins*, 3 Ex. 163.

See also *Queen City Furniture Co. v. Crawford*, 127 Mo. 356 (headline misleading); 30 S. W. 163; *Hub Publishing Co. v. Richardson*, 13 N. Y. Supp. 665; *Bailey v. Macaulay*, 13 Q. B. 815; *Carmody v. Powers*, 60 Mich. 26; 26 N. W. 801 (where the question whether defendants contracted personally had

been submitted to the jury and answered by them in favor of the plaintiff); *Shields v. Clifton Hill Land Co.*, 94 Tenn. 123; 28 S. W. 668; 45 Am. St. Rep. 700; 26 L. R. A. 509.

⁴ *Kelner v. Baxter*, 2 C. P. 174.

See also *Hopcroft v. Parker*, 16 L. T., N. S., 123, 561; *Hurt v. Salisbury*, 55 Mo. 310; *Holland v. Lee*, 71 Md. 338; 18 Atl. 661. *First Nat. Bank v. Church Federation*, 105 N. W. 578; 129 Iowa 268.

But see *Landman v. Entwistle*, 7 Ex. 632.

intention that the promoter should not be personally bound.¹ On the other hand, where the contract is oral merely, so that its terms must be found by the jury, a peremptory instruction to find the defendant individually liable if he promised that the projected company would pay is erroneous;² for the jury should be required to find in addition that the parties intended to contract on the footing of the promoter's individual responsibility. If the contract is made by one promoter expressly as agent for another promoter, from whom sufficient authority was had, the latter promoter is liable, but the former is not.³ Any liability which a promoter incurs is necessarily an original liability as distinguished from a liability as guarantor for the projected corporation.⁴

As there can be no stockholders in a non-existing corporation, subscribers to the capital of a company about to be formed are not liable to persons with whom the promoters contract under any statute imposing a liability in favor of corporate creditors on the stockholders of a corporation.⁵

§ 359. **What is sufficient Evidence of Authority of Co-promoter as Agent.** — As we have seen, promoters are not partners, nor is co-promotership any evidence of partnership;⁶ and hence there is no implied authority in any one or more promoters to bind the others.⁷ In each case, the plaintiff must prove as a fact

¹ *Kelner v. Baxter*, 2 C. P. 174.

But see *Case Mfg. Co. v. Soxman*, 138 U. S. 431, 436-438 (headnote misleading); 11 Sup. Ct. 360.

² *Durgin v. Smith* (Mich.), 94 N. W. 1044; 133 Mich. 331. The inclination of the courts even where the contract is oral is to hold that all who concur in its making intend to be personally bound thereby. *Sandusky Coal Co. v. Walker*, 27 Ont. 677; *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332; 64 N. W. 826; *Roberts Mfg. Co. v. Wright*, 62 Minn. 337; 64 N. W. 827; *Kerridge v. Hesse*, 9 C. & P. 200; *Regester v. Medcalf*, 71 Md. 528; 18 Atl. 966 (where defendant's liability seems to have been assumed).

Cf. *Ennis Cotton-Oil Co. v. Burke*, 39 S. W. 966 (Tex. Civ. App.).

³ *Hersey v. Tully*, 8 Colo. App. 110 (headnote misleading); 44 Pac. 854.

Cf. *McFall v. McKeesport, etc. Ice Co.*, 123 Pa. St. 259; 16 Atl. 478.

⁴ *Clergue v. Humphrey*, 31 Can. Sup. Ct. 66.

⁵ *Buffington v. Bardon*, 80 Wisc. 635; 50 N. W. 776.

⁶ *Supra*, § 311-§ 314.

⁷ *Bright v. Hutton*, 3 H. L. C. 341; *McEwan v. Campbell*, 2 Macq. H. L. 499.

Cf. *Long v. Citizens' Bank*, 8 Utah 104, 107; 29 Pac. 878; *Wilson v. Hotchkiss*, 2 Ont. L. Rep. 261 (where agency was held to have been proved).

actual authority from the defendant to the co-promoter or other person who purported to bind him; and if no legally sufficient evidence of such authority be adduced, the plaintiff will be nonsuited.¹ So, an advertising agent who was unable to give the names of the promoters who were present at the meeting at which his claim was contracted has no enforceable claim against anybody.² That the defendant consented to the publication of a prospectus in which his name appeared as a member of the "provisional committee" and as a promoter of the company does not amount to evidence sufficient to go to the jury of a holding out of the other promoters as his authorized agents;³ since the fact of being co-promoters does not create any agency, the publication of that fact cannot constitute any representation of agency. The mere fact that promoters appoint from among their number a "committee of managers" does not make the members of that committee their agents.⁴ But where promoters by resolution direct their secretary to have certain advertising done, there is evidence to go to the jury of authorization of the secretary to pledge their credit for the necessary expense;⁵ and, in such a case, one of the promoters cannot shield himself behind a secret agreement with his associates that he should incur no liability.⁶ So, where the defendant joins a provisional committee, stating that he "concluded his liability would be limited to the amount of his shares," the court instructed the jury that he was liable for the price of stationery ordered by the secretary and used by the committee.⁷ In some cases, slight evidence of authorization

¹ *Reynell v. Lewis*, 15 M. & W. 517; *Baker v. Stead*, 3 C. B. 946; *Patrick v. Reynolds*, 1 C. B., n. s., 727.

But see *Sproat v. Porter*, 9 Mass. 300. for the prosecution of the project, the authority must be exercised by all the members of the committee, else the intended principals will not be bound. *Brown v. Andrew*, 13 Jur. 938.

Cf. *Railroad Gazette v. Wherry*, 58 Mo. App. 423.

² *Ex parte Lloyd*, 1 Sim., n. s., 248. ⁵ *Maddick v. Marshall*, 17 C. B., n. s., 829 (affirming s. c. 16 C. B., n. s., 387); *Riley v. Packington*, 2 C. P. 536.

³ *Reynell v. Lewis*, 15 M. & W. 517; *Bailey v. Macaulay*, 13 Q. B. 815; *Barker v. Stead*, 3 C. B. 946. But see *Burbidge v. Morris*, 3 H. & C. 664.

Cf. *Collingwood v. Berkeley*, 15 C. B., n. s., 145.

⁴ *Williams v. Pigott*, 2 Ex. 201; *Tanner's Case*, 5 De G. & S. 182. ⁶ *Riley v. Packington*, 2 C. P. 536. Cf. *Rennie v. Clarke*, 5 Ex. 292. ⁷ *Barnett v. Lambert*, 15 M. & W. 489.

And even where the promoters expressly direct a committee of management to take energetic measures Cf. *Collingwood v. Berkeley*, 15 C. B., n. s., 145.

or ratification of the contract has been held sufficient to render a promoter personally liable thereon.¹ But a promoter is not made liable for expenses by attending a meeting at which such liability was recognized, and by endeavoring to devise expedients for raising funds to defray them;² nor by part payment in ignorance of his rights.³ Unless under very exceptional circumstances, a promoter cannot be held liable on a contract made by his co-promoter before he participated in the project;⁴ he cannot be rendered liable on the ground of having ratified the contract.

Where the plaintiff was himself a promoter, the fact has been thought an additional obstacle to his recovery.⁵

§ 360. **Liability distinguished from Liability of Members of Defectively Incorporated Company.** — Inasmuch as promoters are not partners, a suit framed upon the theory that the defendants have incurred a partnership liability as members of a defectively incorporated association cannot be sustained by proof that defendants had incurred a liability as promoters of a prospective corporation.⁶

§ 361. **How Promoter's Liability Discharged — Effect of Company's Adoption of Contract.** — Where a promoter incurs before incorporation a personal contractual liability, he is not discharged by the mere "adoption" of the contract by the corporation;⁷ nor can he be relieved because by express statute the

¹ *Roberts Mfg. Co. v. Schlick*, 62 Minn. 332; 64 N. W. 826; *Roberts Mfg. Co. v. Wright*, 62 Minn. 337; 64 N. W. 827; *Pearson's Case*, 3 De G. M. & G. 241.

² *Tanner's Case*, 5 De G. & S. 182.

As to explaining admissions of liability, see *Newton v. Belcher*, 12 Q. B. 921; *Newton v. Liddiard*, 12 Q. B. 925; *Bailey v. Macaulay*, 13 Q. B. 815.

³ *Ex parte Besley*, 3 Mac. & G. 287.

⁴ *Beale v. Moults*, 10 Q. B. 976.

But see *Lefroy v. Gore*, 1 Jo. & Lat. 571, 587-588.

⁵ *Wilson v. Curzon*, 15 M. & W. 532; *Parkin v. Fry*, 2 C. & P. 311; *Baily v. Burgess*, 48 N. J. Eq. 411; 22 Atl. 73.

⁶ *Shields v. Clifton Hill Land*

Co., 94 Tenn. 123; 45 Am. St. Rep. 700; 26 L. R. A. 509.

⁷ *Kelner v. Baxter*, 2 C. P. 174.

See also *American Paper Bag Co. v. Van Nortwick*, 52 Fed. 752; 3 C. C. A. 274; *Broyles v. McCoy*, 5 Sneed (Tenn.) 602; *Haslett v. Wotherspoon*, 2 Rich. Eq. (S. Car.) 395, 400-401; *Henderson Woolen Mills v. Edwards*, 84 Mo. App. 448; *Bonsall v. Platt*, 153 Fed. 126 (where an agent employed by a promoter recovered from him for services rendered after incorporation as an officer of the company).

But see apparently contra: *Whitney v. Wyman*, 101 U. S. 392; *Smith v. Parker*, 148 Ind. 127, 133-134; 45 N. E. 770; *Wiley v. Borough of Towanda*, 26 Fed. 594; *Ennis Cotton-Oil Co. v. Burke*, 39 S. W. 966 (Tex.);

other party to the contract has a remedy against the company.¹ The facts may, however, be sufficient to establish a novation whereby, with the consent of the other party to the contract, the corporation is substituted in the place of the promoter, who will then be discharged from liability for the future.² Moreover, the promoter's liability may, of course, by the terms of the contract, be made expressly conditional on the receipt of sufficient funds,³ or the failure of the company to adopt the agreement,⁴ or indeed any other event.

§ 362. **Liability for Torts.** — The liabilities of promoters *ex delicto* to persons other than the company both before and after incorporation are governed by the usual principles of the law of torts. The principle that promoters are not partners⁵ protects them from any liability for the torts of each other unless there is actual agency.⁶ But, of course, they are jointly and severally responsible for all torts in which they participate. In other words, they are not protected from liability because they are acting for a corporation, either to be formed or already in existence — a self-evident proposition. For instance, promoters who fraudulently organize a corporation under a name unduly similar to that of an existing concern are personally liable for all damages sustained by the latter.⁷ So, where a corporation is formed for the purpose of violating an injunction against infringing a patent, the promoters are liable individually for the infringement and for the contempt of court.⁸ In some cases, promoters

Chicago Bldg. & Mfg. Co. v. Talbotton Creamery, etc. Co., 106 Ga. 84; 31 S. E. 809; *Heckman's Estate*, 172 Pa. St. 185; 33 Atl. 552 (commented upon supra, § 326).

¹ *Scott v. Lord Ebury*, 2 C. P. 255; *Witmer v. Schlatter*, 2 Rawle (Pa.) 359.

² This may be the explanation of the cases cited in the latter part of note 7, p. 309.

³ *Higgins v. Hopkins*, 3 Ex. 163; *Landman v. Entwistle*, 7 Ex. 632.

⁴ Cf. *Case Mfg. Co. v. Sorman*, 138 U. S. 431 (headnote misleading); 11 Sup. Ct. 360.

⁵ Supra, § 311–§ 314.

⁶ *Wilson v. Hotchkiss*, 2 Ont. L. R. 261 (semble), affirmed in *Milburn v. Wilson*, 31 Can. Sup. Ct. 481.

But see *Getty v. Devlin*, 54 N. Y. 403, 413–414 (reported on a subsequent appeal in 70 N. Y. 504); *Hornblower v. Crandall*, 7 Mo. App. 220, 230, 231, affirmed, 78 Mo. 581.

⁷ *Société Anonyme, etc. v. Panhard-Levassor Motor Co.* (1901), 2 Ch. 513, 516–517.

⁸ *Diamond Drill, etc. Co. v. Kelley Bros.*, 130 Fed. 893.

may be held liable as principals for torts committed by a subordinate without their authority, although if the corporation had been in existence, it would have been the principal and therefore liable instead of the promoters. For instance, promoters who prior to incorporation employ an agent to solicit subscriptions to the shares of the projected company are liable for deceit practised by the agent in procuring subscriptions.¹ In some cases, promoters have been held to stand in a fiduciary relation towards the several shareholders, and the latter have accordingly been allowed to maintain actions for damages sustained in consequence of the promoters' failure to disclose material facts;² but this result is difficult to justify on principle.³

§ 363. **Suits by Promoters on Contracts made on behalf of Projected Corporation.** — The promoters may, of course, sue upon any contract made by them on behalf of a projected corporation upon which according to the principles stated above they might themselves be sued.⁴ A judgment for the defendant in an action by the corporation on such a contract is clearly no bar to a suit by the promoters thereon.⁵ And in estimating the damages sustained by the promoters from the breach of a contract to furnish them machinery for the use of the corporation, the jury may take into account losses sustained by them as members of the company.⁶

§ 364-§ 403. *LIABILITIES OF PROMOTERS TO THE COMPANY.*

§ 364. **No Duty of Active Care for Interests of Company.** — The relation of promoters to the projected company is not such as to cast upon them any positive duty of caring for its interests.

¹ *Milburn v. Wilson*, 31 Can. 248; 22 N. E. 907; 15 Am. St. Rep. Sup. Ct. 481, affirming *Wilson v.* 193; 5 L. R. A. 586.
Hotchkiss, 2 Ont. L. R. 261. But see *Smith v. Parker*, 148 Ind.

² *Brewster v. Hatch*, 122 N. Y. 127, 133-134; 45 N. E. 770.
 349; 25 N. E. 505; 19 Am. St. Rep. 498. ³ *Abbott v. Hapgood*, 150 Mass.

See *infra*, § 413.

⁴ See *infra*, § 413.

⁵ *Abbott v. Hapgood*, 150 Mass. 248; 22 N. E. 907; 15 Am. St. Rep. 193; 5 L. R. A. 586.

For instance, they are under no obligation to use diligence in procuring subscribers to its capital; nor to provide it with a satisfactory constitution. So, if they should negligently omit to insert in the incorporation paper clauses essential to the successful working of the company, nevertheless the latter would doubtless have no claim against them. In a word, their duties to the company are wholly negative; and their liabilities to it arise entirely from their disabilities.

§ 365. **Fiduciary Relation to Company — Three Consequences.** — Being, however, in a position in which profits may readily be made at the expense of the company and its future members and in which they may practically shape the destinies of the enterprise, promoters are deemed in law to occupy a fiduciary relation toward the projected corporation.¹ And from this relation three important consequences flow. | In the first place, all contracts or other dealings by the promoter with the corporation are voidable at the option of the latter unless full disclosure is made by the former of all material circumstances;² secondly, the promoter must account to the corporation for all secret profits made by him out of his fiduciary relation;³ and thirdly, the promoter is liable in damages for any consequences injurious to the company that may result from action on his part inconsistent with his fiduciary position.⁴ While these several principles of law are entirely distinct, yet in many cases and many text-books, a failure to discriminate accurately between them has resulted in much confusion. For although these principles are distinct, yet they overlap, so that to many cases two or more of them apply. Thus, secret profits for which a promoter is accountable are often made out of dealings with the company,

¹ *Old Dominion Copper Mining, etc. Co. v. Bigelow*, 188 Mass. 315; *Densmore Oil Co. v. Densmore*, 64 74 N. E. 653; 108 Am. St. Rep. 479; Pa. St. 43, apparently proceeds on and numerous other cases. The theory that a promoter does not occupy a fiduciary relation to the company unless he is also a director or at least a shareholder; but this distinction is not supported by the authorities generally. The case is commented on *infra*, § 384.

² See *infra*, § 368—§ 374.

³ See *infra*, § 375—§ 399.

⁴ See *infra*, § 400—§ 402.

and, moreover, the profit made by a promoter on a contract with the company is a material circumstance so that unless it be disclosed the corporation may avoid the transaction.¹ Indeed, where the promoter engages in dealings with the company without disclosing some material circumstance the company has three possible remedies: (1) rescission of the contract, (2) affirmance of the contract coupled with a suit to compel the promoter to account for his profits on the transaction, and (3) a suit for damages. Hence, much of the difficulty and complexity attending the subject.

§ 366. **Comparison with Directors.**—The position of promoters with reference to secret profits and with reference to dealings with the corporation is naturally often compared with that of directors. The relation between directors and corporation, however, is a legal status of a definite kind. One may with comparative ease determine when the relationship begins and ends. Moreover, a director's duties are largely prescribed by statute; and the corporation or *cestui que trust* is generally throughout their continuance *sui juris* and able to care for its own interests. A promoter on the other hand is a self-appointed fiduciary. Indeed, a quibbler might object that he is not a fiduciary at all, since no other person has reposed a trust in him.² Consequently, much practical difficulty is encountered in determining when this self-assumed trust originates. Further, a director may, and in general should, abstain wholly from contracting or dealing with the company. But with a promoter, not merely is such abstention impracticable, but indeed the sale of his property to the corporation, or other dealing with it, is often the prime motive impelling him to promote the company. Lastly, a director owes positive duties of vigilance and so forth, while a promoter as above stated incurs no such obligation. Nevertheless, after full effect is given to all these differences, the *disabilities* of directors and promoters in respect to secret profits and dealings with the company are very similar. In considering a case relative to a promoter, the reader is, therefore, cautioned not to neglect the decisions relative to directors, and *vice versa*.

¹ *Maxwell v. Port Tennant Co., ment Ass'n*, 99 Wisc. 54; 74 N. W. 24 Beav. 495; *Hebgen v. Koeffler*, 633. 97 Wisc. 313; 72 N. W. 745; *Limited* ² *Lydney Iron Co. v. Bird*, 33 *Investment Ass'n v. Glendale Invest-* Ch. D. 85.

§ 367. **Liability for Actual Fraud and Deceit.** — In cases of actual affirmative fraud by promoters, relief can generally be obtained by virtue of the general law of torts, without resorting to any peculiar principles of the law of promoters. Thus, if promoters obtain a contract from a corporation by fraudulent misrepresentation, the company may rescind the contract or may affirm the transaction and at the same time sue in an action of deceit for damages. In such an action of deceit against promoters for inducing a corporation which they are promoting to purchase their property, the company cannot charge them with the expenses of its own organization; such damages are too remote.¹ Moreover, not merely may the corporation sue the fraudulent promoters for deceit, but every shareholder or other person who is intended to and does rely upon the misrepresentation has the same remedy. If all the existing members of the company are concerned in the fraud or otherwise acquainted with the facts, the corporation as a legal entity cannot be said to rely on the misrepresentation, and consequently would have no action for deceit. Individual shareholders or bondholders, however, who subscribe on the faith of the misstatement, might sue the promoters at law for deceit. A natural reluctance to make, or to sustain, the serious charge of fraud prevents many cases from being placed on that ground. The peculiar principles of the law of promoters come into play only when the ordinary liability for fraud or other tort cannot be made out or is not sought to be enforced.

§ 368–§ 374. *Rescission by Corporation of Contracts with Promoters.*

§ 368. **In general.** — As already implied, a promoter is not precluded from selling property to the corporation, or otherwise dealing with it, provided full disclosure is made of all circumstances likely to affect the action of the company as to the proposed contract. But unless full disclosure of all material facts is made by the promoter, the company may rescind any contract between itself and him.² The promoter is a fiduciary

¹ *Cortes Co. v. Thannhauser*, 45 N. E. 653; 108 Am. St. Rep. 479; Fed. 730, 739–740. *Camden Land Co. v. Lewis*, 101 Me.

² *Old Dominion Copper Mining*, 78; 63 Atl. 523 (semble), and many etc. *Co. v. Bigelow*, 188 Mass. 315; 74 other cases cited below.

and the company is, so to speak, the *cestui que trust*; and consequently dealings between the promoter and the company are subject to the rules which govern transactions between a trustee and his *cestui que trust*, but are not entirely prohibited as are contracts between a trustee, acting on behalf of the trust estate, and himself acting on his own behalf. For instance, a failure to disclose that a foreign concession which the promoter is selling to the company has become liable to forfeiture will entitle the latter to avoid the contract.¹ Indeed, transactions between a promoter and his corporation are *prima facie* voidable; and the burden of sustaining them by proof of full disclosure rests upon the promoter,² although when the corporation sues to recover a promoter's secret profits, the rule is otherwise, the burden of proving non-disclosure resting on the company.³ A provision in the contract between the corporation and the promoter that it shall not be voidable for non-disclosure is ineffective.⁴ A court of equity has jurisdiction of a bill by the company for rescission of the contract.⁵

§ 369. **What Disclosure sufficient, and to whom it must be made, to render Contract binding.**—As to what form of disclosure is sufficient and to whom the disclosure must be made, the same principles would seem to apply in these rescission cases as in cases of alleged secret profits; and therefore the whole matter is treated below.⁶ It should be borne in mind, however, as stated in the preceding paragraph, that in the former class of cases the burden of proving disclosure is on the promoter while in the latter the company must prove non-disclosure.

§ 370. **Return of Consideration as Condition of Rescission.**—Ordinarily an offer by the company to return the consideration received by it is a condition precedent to rescission, but where the consideration has ceased to exist without the company's fault a failure to make such an offer is excused.⁷ Where

¹ *Phosphate Sewage Co. v. Hartmont*, 5 Ch. D. 394.

² See *Rice's Appeal*, 79 Pa. St. 168, 204.

³ *Bentinck v. Fenn*, 12 A. C. 652. See *infra*, § 392.

⁴ *Gluckstein v. Barnes* (1900), A. C. 240.

Cf. *Watts v. Bucknall* (1902), 2 Ch. 628.

⁵ *Old Dominion Copper Mining, etc. Co. v. Bigelow*, 188 Mass. 315;

74 N. E. 653; 108 Am. St. Rep. 479; *Fred Macey Co. v. Macey*, 143

Mich. 138; 106 N. W. 722.

⁶ *Infra*, § 395—§ 398.

⁷ *Phosphate Sewage Co. v. Hartmont*, 5 Ch. D. 394.

the consideration consists of land sold to the company, for which, however, no deed had been executed, an offer to restore possession to the vendor is a sufficient tender of a return of the consideration.¹

§ 371. **Waiver of Right to Rescind.** — The right of rescission is a privilege which the company may elect to refrain from exercising. Consequently, the contract may be confirmed by the company either expressly or impliedly, and thereafter will be unimpeachable. The right of the company to rescind cannot, however, be barred by any confirmation of the contract by the company or its shareholders without full knowledge of the facts, including the promoter's profit.² The confirmation is itself voidable unless the company was then apprised of all material facts.

§ 372. **Laches of Company.** — The corporation's right to rescind the transaction may be barred by laches.³ But in computing laches, time during which the company had a board of directors controlled by the promoters is not to be reckoned.⁴ The failure of a shareholders' meeting, which was regarded as merely formal and was attended by a small minority of the members, to take steps looking to rescission cannot bar the company.⁵ Nor is it laches for a shareholders' meeting, instead of rescinding the contract at once, which would involve an abandonment of the undertaking, to appoint a committee of inquiry.⁶ Where, however, the property sold to the company by the promoters is of a wasting character, such as a nitrate bed, rescission will not be granted after the property has been impoverished.⁷ At all events, rescission or anything in the nature of rescission is clearly impossible after the corporation has parted with the

¹ *Cortes Co. v. Thannhauser*, 45 Fed. 731, 739.

² See *Hebgen v. Koeffler*, 97 Wisc. 313; 72 N. W. 745.

³ Cf. *Fred Macey Co. v. Macey*, 143 Mich. 138; 106 N. W. 722 (where the company having protested promptly on discovery of the facts and having consumed time in a fruitless effort to reach a settlement out of court was held not to be barred).

⁴ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392, 433.

⁵ *Erlanger v. New Sombrero Phosphate Co.*, 3 A. C. 1218, 1251, 1258.

⁶ *Erlanger v. New Sombrero Phosphate Co.*, 3 A. C. 1218.

⁷ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392; *Vigers v. Pike*, 8 Cl. & Fin. 562.

Cf. *Erlanger v. New Sombrero Phosphate Co.*, 3 A. C. 1218.

property;¹ for the company is then unable to restore the consideration.

§ 373. **Effect of Dissolution of Corporation on Right of Rescission.** — Question has been made whether rescission can be granted after corporate existence has expired;² but it would seem that the powers of chancery ought to be capable of preventing such an accident from defeating an equity.

§ 374. **Rights of individual Shareholders.** — The right of rescission when it exists is vested in the company, and cannot be exercised by any individual shareholder.³ An individual shareholder can sue for rescission only where the circumstances are such as to entitle him to maintain a shareholder's bill on behalf of the corporation.

§ 375—§ 399. **LIABILITY OF PROMOTERS TO ACCOUNT TO CORPORATION FOR THEIR PROFITS.**

§ 375. **In general.** — The right of the principal or *cestui que trust* to all secret profits made by the agent or trustee out of his fiduciary position is well recognized and long established, and applies with full force as between corporation and promoter. The doctrine is an equitable one, and therefore a court of equity has jurisdiction of a suit by the company to recover a promoter's secret profits although it may be only a money demand.⁴ Profits so made by a promoter belong in equity to the company, and if the company's treasurer knowingly pays out the money from the company's funds to the promoter, his official bond is liable therefor.⁵

§ 376. **Classification of Cases in which unlawful Profits are made.** — Such secret profits are usually made either (1) on some transaction between the promoter and a person selling property to the corporation or otherwise dealing with it, or else (2) on some direct dealing between the promoter and the corporation.

¹ *Salomon v. Salomon & Co.* (1897), A. C. 22, 54 (per Lord 188. Macnaghten). ⁴ *McElhenny's Appeal*, 61 Pa. St.

² *Lindsay Petroleum Co. v. Hurd*, L. R. 5 P. C. 221. ⁵ *First Ave. Land Co. v. Hildebrand*, 103 Wisc. 530; 79 N. W. 753.

³ *Urner v. Sollenberger*, 89 Md. 316; 43 Atl. 810.

§ 377-§ 382. *Profits made on Transactions between Promoter and Persons having Dealings with Company.*

§ 377. **Outright Bribes.** — In the first class of cases, the secret profit in its grossest form takes the shape of an out-and-out bribe, or present, given by one dealing or intending to deal with the corporation, for the corrupt purpose of inducing the promoter to exercise his control over the company rather for the interests of the bribe-giver than for the interest of the corporation. Such a bribe or present belongs in equity to the company, and cannot be retained by the promoter. An instance may be found in *Emma Silver Mining Co. v. Lewis*.¹ There the owners of a mine in America who were organizing a corporation to purchase the property agreed to give their London agent a portion of the purchase money, to induce him, when applied to for information by intending subscribers to the capital, to refrain from stating certain facts which might throw doubt on the value of the property. This agreement having been carried out, it was held, of course, that the company could recover the bribe from the London agent. In a comparatively early case in the House of Lords, it was held, or said, that where the bribe consists in land, the company cannot treat the promoter as holding it upon trust for itself, but is limited to the recovery of such damages as it may have suffered from his dereliction of duty.² But it is submitted that, in spite of this high authority, the law is otherwise both in England and the United States.³ The company need not show that the bribe has produced any effect or influenced the promoter's conduct, much less that the company has suffered any damage.⁴ Recovery is not sought because of damages sustained, but for profits made by the company's fiduciary and belonging in equity to the company as *cestui que trust*.

§ 378. **Commissions and other Veiled Bribes.** — A bald bribe rather rarely occurs. The company, however, is entitled to all undisclosed profits made by a promoter by gifts from or deal-

¹ *Emma Silver Mining Co. v. Lewis*, 4 C. P. D. 396. accepted as a bribe, compare cases with reference to directors, *infra*,

² *Tyrrell v. Bank of London*, 10 H. L. C. 26, 59. § 1617-§ 1619.

⁴ *Yale Gas Stove Co. v. Wilcox*,

³ For the whole subject of the rights and liabilities of the parties where stock or property has been 64 Conn. 101, 125; 29 Atl. 303; 42 Am. St. Rep. 159; 25 L. R. A. 90.

ings with a vendor to the company or other person having to do with it. No actual bribery is necessary to recovery; it is enough that the *tendency* of such secret profits is to lead the promoter from the path of duty. Thus, a promoter must account to the company for all sums secretly received by him from one selling property to it, whether as commission for his services in organizing the company,¹ or otherwise.² Where a promoter holds an option for the purchase of land from W, its owner, for \$25,000, and the company agrees to buy the land from W for a larger sum, the promoter cannot exercise his option, transfer the title from himself to the company, and pocket the difference between the \$25,000 and the amount which the company agreed to pay; to do so would practically be to receive a secret commission from W, whom the company understood to be the real vendor to it.³

§ 379. **Mutual Rights of Bribe-giver and the Company.** — Not merely may the corporation recover the bribe or commission from the promoter when it has been paid to him, but also may treat any such agreement between him and the vendor as made for its own benefit; and therefore may recover from the vendor any sums which he has agreed to pay to the promoter out of the purchase money, but which he has not yet actually paid.⁴ Indeed, the vendor is liable to the company for the amount of the bribe although he has already paid it over to the promoter;⁵ and in such a case the fact that the promoter is a large shareholder in the company so that a part of the amount recovered by it would ordinarily inure to his own benefit is no defence in whole or in part to an action at law by the company against the vendor.⁶

§ 380. **Mutual Rights of Bribe-giver and Promoter.** — Of course, if the secret commission has been collected by the company from the vendor, the promoter cannot recover it from the

¹ *Lydney Iron Co. v. Bird*, 33 Ch. D. 85; *The Telegraph v. Loetscher*, 101 N. W. 773; 127 Iowa 383. *Gas Stove Co. v. Wilcox*, 64 Conn. 101, 125; 29 Atl. 303; 42 Am. St. Rep. 159; 25 L. R. A. 90.

² *Bland's Case* (1893), 2 Ch. 612; *Hichens v. Congreve*, 4 Russ. 562; *Cook v. Climber Co.*, 75 Miss. 121; 21 So. 795; *Koster v. Pain*, 41 N. Y. App. Div. 443; 58 N. Y. Supp. 865. ³ *Plaquemines, etc. Co. v. Buck*, 52 N. J. Eq. 219, 230-237.

⁴ *Whaley Bridge Calico Co. v. Green*, 5 Q. B. D. 109.

⁵ *Grand Rapids, etc. Co. v. Cincinnati, etc. Co.*, 45 Fed. 671.

⁶ *Grand Rapids, etc. Co. v. Cincinnati, etc. Co.*, 45 Fed. 671. It makes no difference that the property may be fully worth the price paid by the company. *Yale*

company.¹ Indeed, the agreement between the promoter and the vendor being illegal, the former cannot in any case maintain an action thereon against the latter to recover the promised bribe or present.²

§ 381. **Company's Right to recover Bribe independent of its Right to avoid its Contract with Bribe-giver.** — While the fact that a bribe or secret profit has been received by a promoter from a vendor or other person dealing with the company gives the corporation the right to rescind the sale or other contract,³ yet that right is entirely independent of its right to recover the secret profit made by the promoter. Accordingly, the secret profit may be recovered, although the company chooses to affirm the sale.⁴ Or, if the company receives from the vendor a sum of money in consideration of its abandonment of the claim for rescission, it may nevertheless recover the full amount of the secret profit made by the promoter, who is not entitled to deduct or recoup the sum so received from the vendor.⁵ But it has been held that where the company abandons its claim to rescission, its case also falls against one whose only misconduct or indiscretion consisted in acting as solicitor both for the corporation and the vendors.⁶

§ 382. **Promoter's Right to set-off or recoup Expenses incurred on Company's behalf.** — The English courts have several times held that where a secret payment is made by a vendor to a promoter out of the purchase money, the promoter may reduce the company's claim therefor by the amount of his expenses incurred in organizing the corporation.⁷ As pointed out

¹ *Central Land Co. v. Obenchain*, *Congreve*, 4 Russ. 562, 4 Sim. 420; 92 Va. 130; 22 S. E. 876.

² *Wilcox v. Foley*, 64 Conn. 101, 129; 29 Atl. 303; 42 Am. St. Rep. 159; 25 L. R. A. 90.

³ Cf. *Harrington v. Victoria, etc. Dock Co.*, 3 Q. B. D. 549, a case of an ordinary agent instead of a promoter.

But see *Mayor, etc. of Salford v. Lever* (1891), 1 Q. B. 168.

⁴ *Supra*, § 368 et seq.

⁵ *Emma Silver Mining Co. v. Lewis*, 4 C. P. D. 396; *Lydney Iron Co. v. Bird*, 33 Ch. D. 85; *Bland's Case* (1893), 2 Ch. 612; *Hichens v.*

Congreve, 4 Russ. 562, 4 Sim. 420; *Tyrrell v. Bank of London*, 10 H. L.

C. 26; *Yale Gas Stove Co. v. Wilcox*, 64 Conn. 101; 29 Atl. 303; 42 Am. St. Rep. 159; 25 L. R. A. 90; *Hayward v. Leeson*, 176 Mass. 310, 322; 57 N. E. 656; 49 L. R. A. 725.

⁶ *Bagnall v. Carlton*, 6 Ch. D. 371.

⁷ *Bagnall v. Carlton*, 6 Ch. D. 371. See also *infra*, § 385.

⁸ *Bagnall v. Carlton*, 6 Ch. D. 371; *Lydney Iron Co. v. Bird*, 33 Ch. D. 85; *Emma Silver Mining Co. v. Grant*, 11 Ch. D. 918. Accord:

Co. v. Bird, 33 Ch. D. 85; *Bland's Case* (1893), 2 Ch. 612; *Hichens v.*

Hayward v. Leeson, 176 Mass. 310, 322; 57 N. E. 656; 49 L. R. A. 725.

in another place,¹ so far as the promoter is allowed for expenses prior to incorporation, this doctrine seems inconsistent with the English rule by which promoters are not permitted to recover from the company their expenses in bringing it out. The payments for which the promoter may obtain allowance need not be strictly moral or such as to commend themselves to the court: for instance, promoters have in such cases been allowed for money spent to induce prominent men to serve as directors and for "bulling" the company's securities.² No payment can be allowed, however, which is *ultra vires* of the company.³ Nor will the promoters be permitted to retain a commission for their own services.⁴

§ 383-§ 390. *Profits made on a Transaction between Promoters and the Company.*

§ 383. *In general.* — The second class of cases in which secret profits are commonly made by promoters is on direct dealings between themselves and the company. As already stated, such contracts are voidable by the corporation unless full disclosure is made of all material circumstances including the promoter's interest in the transaction.⁵ If this right of rescission is exercised by the company, the promoter must be restored to his *status in quo*, so that necessarily he can derive no profit from the transaction; and hence no question as to the company's right to recover profits could arise.⁶ But if the company elects to affirm the contract, or if the right to rescind is lost by laches or otherwise, the question becomes very important how far the corporation is entitled to the promoter's profit. In general, it seems clear that such profit unless disclosed may be recovered by the company in spite of the failure to rescind.⁷

§ 384. *Purchase of Property by Promoter and Resale to Company — Measure of Promoter's Profit.* — Thus, where a promoter after starting to organize a corporation, purchases prop-

¹ Supra, § 339.

² *Emma Silver Mining Co. v. Grant*, 11 Ch. D. 918.

³ *Lydney Iron Co. v. Bird*, 33 Ch. D. 85.

⁴ *Bagnall v. Carlton*, 6 Ch. D. 371.

⁵ Supra, § 368 et seq.

⁶ It is said that an election to rescind, once made, cannot be retracted by the company. *Limited Investment Ass. v. Glendale Investment Ass.*, 99 Wisc. 54, 58; 74 N. W.

⁷ *Ex-Mission Land, etc. Co. v. Flash*, 97 Cal. 610, 636; 32 Pac. 600.

erty for the purpose of selling it to the company at an advance, and afterwards does so sell it, but without disclosing his ownership, or the price at which he purchased, or other material fact, the corporation may recover from him his profit on the purchase and resale.¹ In other words, the corporation may treat the purchase made by its fiduciary as made for its benefit.² But where the promoter's purchase was completed before any step toward forming the corporation was taken, the question is more difficult. In that case, clearly the company cannot recover from the promoter the excess of the price paid by it over that at which the promoter at some time past may have bought. For that is not the measure of the promoter's profit; his purchase antedating the promotion of the corporation cannot be taken as made for the company's benefit.³ His profit is the difference between the price paid by the corporation and the actual saleable value of the property at the time of the purchases by the company; and unless such a difference is proved, the company's claim to the promoter's profit must fail for the simple reason that the promoter

¹ *Tyrrell v. Bank of London*, 10 H. L. C. 26 (failure to disclose fact of promoter's ownership); *South Joplin Land Co. v. Case*, 104 Mo. 572; 16 S. W. 390 (failure to state price paid by promoter); *Woodbury Heights Land Co. v. Loudenslager*, 55 N. J. Eq. 78; 35 Atl. 436 (reversed in part in *Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556; 43 Atl. 671); *Plaquemines, etc. Co. v. Buck*, 52 N. J. Eq. 219, 237-240; 27 Atl. 1094; *Burbank v. Dennis*, 101 Cal. 90; 35 Pac. 444 (a case of affirmative fraud); *McElhenny's Appeal*, 61 Pa. St. 188, 195; *Exter v. Sawyer*, 146 Mo. 302; 47 S. W. 951 (failure to disclose price paid by promoter); *Pietsch v. Milbrath*, 101 N. W. 388; 123 Wisc. 647; 107 Am. St. Rep. 1017 (rehearing denied, 102 N. W. 342); *Walker v. Pike County Land Co.*, 139 Fed. 608; 71 C. C. A. 593 (promoter falsely representing that he had no interest in property and that owners would not sell for less than company was paying); *Central*

Trust Co. v. East Tennessee Land Co., 116 Fed. 743; *Yeiser v. U. S. Board, etc. Co.*, 107 Fed. 340; 46 C. C. A. 567; 52 L. R. A. 724.

Cf. *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 203-206; 20 Sup. Ct. 311; *Leeds and Hanley Theatres* (1902), 2 Ch. 809, 813-814, 821-822, 825 (where the proposition stated in the text was approved by Wright, J., but questioned by the Court of Appeal).

² See *infra*, § 399.

³ *Burbank v. Dennis*, 101 Cal. 90, 98; 35 Pac. 444; *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43; *Hess Mfg. Co.*, 23 Can. Sup. Ct. 644 (affirming S. C., 21 Ont. App. 66); *Milwaukee Cold Storage Co. v. Dexter*, 99 Wisc. 214; 74 N. W. 976; 40 L. R. A. 837; *Lady Forrest (Murchison) Gold Mine* (1901), 1 Ch. 582.

Cf. *Spaulding v. North Milwaukee Town Site Co.*, 106 Wisc. 481; 81 N. W. 1064; *Highway Advertising Co. v. Ellis*, 7 Ont. L. R. 504.

made no profit.¹ This would seem to be the true ground for the decision in *Densmore Oil Co. v. Densmore*.² There, an owner of property organized a corporation to purchase it, and the company afterwards brought suit to recover the difference between the price it had paid and that at which the vendor had bought; and it was quite properly held that the company could not recover that amount. And moreover, since the land was worth on the market the full price paid for it by the company, the promoter really made no profit, and could therefore be accountable for none, so that a judgment for the defendant was properly entered. In that way, the actual decision may be supported; but the court took the ground that a vendor who had owned property before beginning the promotion of a company to purchase it, deals with the corporation at arm's length, and is under no duty of disclosure — a position which under the existing authorities can hardly be maintained, and which on principle seems clearly unsound. It is therefore submitted that the decision should be rested on the ground, not that the vendor and promoter was entitled to retain his profit, but that he had in the eye of the law made no profit.

§ 385. *Continuation — Cape Breton Company's Case.* — But what if a property-owner whose ownership preceded his idea of organizing a corporation secures from the company which he subsequently causes to be formed a good price for his property — more than what the court finds to have been the saleable value of the property — and that, too, although without actual misrepresentation, yet without disclosing the fact of his ownership? May the company recover the difference between the price paid to the promoter and the true value? It has been twice held by the English Court of Appeal that the company cannot do so if the promoter practised no actual fraud or misrepresentation, his only default being a failure to disclose his interest in the property sold.³ The only remedy of the corporation, it was held, was

¹ *Bentinck v. Fenn*, 12 App. Cas. 795 (affirmed on another ground by 652 (approved in *Milwaukee Cold Storage Co. v. Dexter*, 99 Wisc. 214, 12 A. C. 652); *Ladywell Mining Co. v. Brooks*, 35 Ch. D. 400; *Lady Forrest (Murchison) Gold Mine* (1901), 1 Ch. 582. In the Cape Breton Case the corporation had voluntarily refused to rescind while

² *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43.

³ *Re Cape Breton Co.*, 29 Ch. D.,

by rescission of the sale. This doctrine seems to create an arbitrary exception to the usual principle with respect to secret profits; and accordingly it has been much criticised.¹ But it has recently been reaffirmed by the Privy Council,² and therefore seems to represent the law of England and the British Colonies. In America different results may yet be hoped for.³

§ 386. *Continuation — Gluckstein v. Barnes.* — A decision not easy to square with the doctrine of the Cape Breton Case discussed in the last paragraph is *Gluckstein v. Barnes*.⁴ In that case, a joint-stock company was being wound-up; and, as its assets were currently believed to be insufficient to pay its debenture-holders, the debentures were selling below par. A syndicate bought a number of these debentures at less than par, and also purchased the business of the defunct company from its liquidator for £140,000. Of course, by reason of their ownership of the debentures, a large part of this purchase price would eventually find its way back to their own hands; and in fact they realized a profit of £20,000 on the debentures. The syndicate sold the business of the old company to a corporation organized by themselves for the sum of £180,000. They stated publicly that they had bought the property at £140,000, but did not disclose their ownership of the debentures. The House of Lords held that the corporation, although it had failed to rescind the sale, could nevertheless recover from the syndicate the profit of £20,000 derived from the ownership of the debentures. The case may be distinguished from the Cape Breton Case, and the cases following it, in two ways. In the first place, the immediate organization of the company was contemplated at the time the

in the Ladywell Case rescission had become impracticable by the impossibility of returning the consideration; but this distinction was held to make no difference in the result.

Cf. *Ely v. Hanford*, 65 Ill. 267; *Olympia Ltd.* (1893), 2 Ch. 153, 170 (where Lindley, M. R., said that the Cape Breton Case did not decide that, as a general proposition, the mere impossibility of rescinding a contract for a purchase by a company precludes the company from obtaining from the vendor if he is a

promoter a secret profit made by him at its expense).

¹ Lindley on Companies, 6th ed., 501-503.

² *Burland v. Earle* (1902), A. C. 83, 98-99.

³ Cf. *Yeiser v. U. S. Board, etc. Co.*, 107 Fed. 340; 46 C. C. A. 567; 52 L. R. A. 724.

But see *Insurance Press v. Montauk, etc. Wire Co.*, 103 N. Y. App. Div. 472; 93 N. Y. Supp. 134.

⁴ *Gluckstein v. Barnes* (1900), A. C. 240 (affirming *Re Olympia* (1898), 2 Ch. 153).

syndicate purchased the business and the debentures; and in the second place the statement that the syndicate were making a profit of £40,000, whereas including the debenture transaction the profit was £60,000, was a half-truth very nearly if not quite equivalent to a positive misrepresentation. Yet, one may well doubt whether these distinctions constitute a real difference. At all events, whether or not the cases can be reconciled in principle, everybody will agree that *Gluckstein v. Barnes* is a sound decision.

§ 387. **Dicta that Promoter in making Resale deals at Arm's Length.** — In a few American cases the opinion has been intimated that one who has owned property before beginning the promotion of the company may deal at arm's length with the corporation which he organizes, and dispose of such property to it without disclosing the price he paid for it, or other material circumstances.¹ But it is submitted that these dicta are not law. As promoter, he stands in a fiduciary relation towards the company which he organizes, and may not deal with it "at arm's length." But if he comes short of that standard of frankness which the law requires, he cannot be treated as if his original acquisition of the property had been as trustee for the company — the corporation must find some other remedy.

§ 388. **Effect of false Representation that Property is resold at same Price paid by Promoter.** — If promoters represent to the company that they are selling to it at the price at which they themselves bought, they have been held liable to it for the difference between that price and the price at which they really bought, irrespective, apparently, of the circumstance that their ownership antedated the conception of the corporation;² having represented to the company that it might purchase from them for the price which they themselves had paid, they will be required to make good the assertion.

§ 389. **Sale to Company by Promoter holding Option of Purchase.** — So, too, where a promoter having acquired options for the purchase of property before beginning the organization of a

¹ *Densmore Oil Co. v. Densmore*, N. Y. App. Div. 382; 87 N. Y. Supp. 64 Pa. St. 43 (discussed supra, 369 (per Ingraham, J.).

§ 384); *Milwaukee Cold Storage Co.* ² *Simons v. Vulcan Oil Co.*, 61 v. *Dexter*, 99 Wisc. 214; 74 N. W. Pa. St. 202; 100 Am. Dec. 628. 976; 40 L. R. A. 837.

Cf. *Hutchinson v. Simpson*, 92

company, afterwards disposes of it to the corporation for a price in excess of the amount of his options without disclosing this fact, he is liable to the company for the difference: ¹ he as a fiduciary is, under the circumstances, to be regarded in equity as exercising the option for the benefit of the company, his *cestui que trust*.

§ 390. **Albion Steel Co. v. Martin.** — An instructive case is *Albion Steel Co. v. Martin*.² There, M agreed to serve as director in a company which was being formed for the purpose of purchasing F's business. Subsequently, both before and after incorporation, M entered into a number of contracts with F in the usual course of trade; and these contracts, in accordance with an ante-incorporation arrangement, the company, on purchasing F's business, agreed to carry out. It was held that M was not liable to the company for his profits on such of these contracts as were made before incorporation. The case proceeds upon the ground that as to those contracts, M was not acting in a dual capacity, but exclusively for his own interest. Perhaps the most satisfactory reason for the decision is that profits derived from such contracts made *bona fide* in the regular course of business and not directly with the company cannot be regarded as made by the promoter by virtue of his fiduciary position.

§ 391. **Profits made with Money realized upon Illegal Sale of Stock.** — The fact that the money out of which promoters make clandestine profit was obtained by the company by an illegal sale or issue of its stock is no objection to a recovery of that profit by the company.³

§ 392. **Company's Claim founded on Breach of Trust — Bankruptcy of Promoter — Limitations and Laches.** — Promoters are

¹ *Exter v. Sawyer*, 146 Mo. 302; Mass. 310 (headnote inadequate); 47 S. W. 951; *Pittsburg Mining Co. v. Spooner*, 74 Wisc. 307; 42 N. W. 259; 17 Am. St. Rep. 149 (where the case was made clearer by the positive misrepresentation of which the promoters had been guilty); *Yeiser v. U. S. Board & Paper Co.*, 107 Fed. 340; 46 C. C. A. 567; 52 L. R. A. 724.

But see *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382; 87 N. Y. Supp. 369.

² *Albion Steel Co. v. Martin*, 1 Ch. D. 580.

³ *Pittsburg Mining Co. v. Spooner*, 74 Wisc. 307, 324-328; 42 N. W. 259; 17 Am. St. Rep. 149.

See also *Hayward v. Leeson*, 176

deemed so far fiduciaries that a claim against them for secret profits has been held to arise from "breach of trust" so as not to be barred by a discharge in bankruptcy under the English statute.¹ By parity of reasoning, the ordinary statute of limitations would not begin to run against it until the facts are communicated to a disinterested board of directors.² Clearly, therefore, such a claim will not be barred by laches for a shorter time than the statutory period of limitations.³ The right of a company to rescission of a contract made with a promoter may, however, be lost by laches.⁴

§ 393. **Whether Liability is Several or Joint.** — Where several promoters, out of one transaction and in pursuance of one common scheme, make clandestine profits, each is liable, according to what is probably the prevailing view, for the full amount of such profits, and not merely for the share which he has received;⁵ but the New Jersey Court of Errors has held that each promoter is liable only for his own share.⁶

§ 394. **Burden of Proof — Fact of Profit and Non-disclosure.** — A corporation seeking to recover a promoter's secret profits, like any other plaintiff, must prove its case. It must prove that the promoter made a profit;⁷ and that such profit was not disclosed so fully and frankly as the law requires. There is no presumption of secrecy; but the burden of proving it rests

¹ *Emma Silver Mining Co. v. Grant*, 17 Ch. D. 122.

² *The Telegraph v. Loetscher*, 101 N. W. 773; 127 Iowa 383.

But cf. *Re Fitzroy Bessemer Steel Co.*, 50 L. T. 144; *Pietsch v. Milbrath*, 101 N. W. 388; 102 N. W. 342; 123 Wisc. 647; 107 Am. St. Rep. 1017.

³ *Ex-Mission, etc. Land Co. v. Flash*, 97 Cal. 610, 632; 32 Pac. 600.

⁴ *Supra*, § 372.

⁵ *Zinc Carbonate Co. v. First Nat. Bank*, 103 Wisc. 125, 135; 79 N. W. 229; 74 Am. St. Rep. 845.

Cf. *Fountain Spring Park v. Roberts*, 92 Wisc. 345; 66 N. W. 399; 53 Am. St. Rep. 917; *Old Dominion Copper Mining, etc. Co. v. Bigelow*, 188 Mass. 315; 74 N. E. 653; 108 Am. St. Rep. 479.

See also cases as to directors, *infra*, § 1629.

⁶ *Loudenslager v. Woodbury Heights Land Co.*, 58 N. J. Eq. 556; 43 Atl. 671.

⁷ *Bentinck v. Fenn*, 12 A. C. 652.

Cf. *Milwaukee Cold Storage Co. v. Dexter*, 99 Wisc. 214; 74 N. W. 976; 40 L. R. A. 837 (where the promoter paid large sums of money out of his own pocket to induce a capitalist to subscribe or procure subscriptions to the company's capital, and to content a subscriber to shares from whom the promoter had purchased land afterwards sold to the corporation and who was dissatisfied with the low price he had received and the larger price the promoter was receiving).

upon the company.¹ On the other hand, an agreement by the promoter to keep the matter secret is as against him sufficient proof of non-disclosure in the absence of any evidence to the contrary.²

§ 395-§ 398. *What is sufficient Disclosure of Profit by Promoter.*

§ 395. **Question the same whether Company seeks Rescission of Transaction or Recovery of Profit.** — The next question is, what sort of disclosure is sufficient, and to whom must it be made? As already stated, this question is the same whether the corporation is asking the recovery of a promoter's profits or the rescission of a transaction between him and the company.³

§ 396. **Disclosure must be Actual, Full, and Frank.** — In either case there must be actual disclosure; mere lack of concealment is no protection.⁴ And it is not enough merely to give warning or even to afford means of discovery.⁵ "Refined equitable doctrines of constructive notice have little, if any, application to such matters as are now being dealt with. To inform a person of a fact is one thing; to give him the means of finding it out, if he will take trouble enough, is another thing. A promoter of a company whose duty it was to disclose what profits he has made, does not perform that duty by making a statement not disclosing facts, but containing something which, if followed up by further investigation, will enable the inquirer to ascertain that profits have been made and what they amount to."⁶ Upon somewhat the same principle, a statement that the price of property sold to the company is to be paid to the vendor "or his nominees" is not a sufficient disclosure that part of it is to be paid to

¹ *Bentinck v. Fenn*, 12 A. C. 652. Contra: *Colton Improvement Co. v. Richter*, 26 N. Y. Misc. 26; 55 N. Y. Supp. 486 (semble).

As stated supra, § 368, the burden of proof is probably different where the company seeks rescission of a contract with a promoter, in which case the promoter has the burden of establishing disclosure of all material facts.

² See *Archer's Case* (1892), 1 Ch. 322 — a case of a director instead of a promoter.

³ Supra, § 369.

⁴ *Hayward v. Leeson*, 176 Mass. 310, 320; 57 N. E. 656; 49 L. R. A. 725. Difficult to reconcile is *Blum v. Whitney*, 185 N. Y. 232.

⁵ *Gluckstein v. Barnes* (1900), A. C. 240.

But see *Hodge v. U. S. Steel Corp.*, 64 N. J. Eq. 807; 54 Atl. 1; 60 L. R. A. 742.

⁶ Per Lindley, M. R., in *Re Olympia* (1898), 2 Ch. 153, 166 (affirmed by House of Lords in *Gluckstein v. Barnes*, ubi supra).

a promoter.¹ Also, where a promoter who had no interest in certain land purported to unite with the owners in selling it to a corporation, he is accountable for the portion of the purchase money paid to him for his services in promoting the company, since the disclosure of his pretended interest as vendor cannot protect him as to profits made not in that capacity but as promoter.² Disclosure of the fact that promoters are making a profit is not enough; the amount also must be disclosed.³ Disclosure in order to be effective must be both full and frank.

§ 397. To whom the Disclosure should be made — To Directors, Shareholders, the Public, etc. — Unquestionably, the safest course for promoters is to provide the company with an independent board of directors to whom to make this full and frank disclosure. An independent board of directors means a board not under the control of the interested promoters; but a board may be independent although nominated by the interested promoters. Ordinarily, where there is no disclosure to the shareholders an independent board of directors is indispensably necessary for the protection of the promoters.⁴ Of course, a so-called disclosure by the promoters to themselves as directors of the company is illusory, and wholly ineffective.⁵ So also, where a prospectus is issued misstating material facts, "disclosure" to the directors of the untruth of the prospectus is wholly nugatory, since the public have a right to act on the prospectus, and the directors by failing to publish the disclosure practically make themselves parties to the fraud, and so cease to be "independent."⁶ In one or two American cases, the existence of an independent directorate has been apparently thought to obviate the necessity for any disclosure at all;⁷ but this could not be held without overturning the whole law of promoters as established by the decisions.

¹ *McKay's Case*, 2 Ch. D. 1, 3.

² *Bland's Case* (1893), 2 Ch. 612.

³ *Lady Forrest (Murchison) Gold Mine* (1901), 1 Ch. 582.

⁴ *Erlanger v. New Sombrero Phosphate Co.*, 3 A. C. 1218.

Cf. *Burbank v. Dennis*, 101 Cal. 90, 101; 35 Pac. 444 (where it seems to be laid down that in a case of actual fraud, disclosure to directors will never be sufficient. *Sed quære*).

⁵ *Gluckstein v. Barnes* (1900),

A. C. 240; *Lagunas Nitrate Co. v.*

Lagunas Syndicate (1899), 2 Ch.

392, 431; *Hayward v. Leeson*, 176

Mass. 310, 319-320; 57 N. E. 656;

49 L. R. A. 725.

⁶ *Simons v. Vulcan Oil Co.*, 61

Pa. St. 202, 221; 100 Am. Dec. 628.

⁷ *Densmore Oil Co. v. Densmore*, 64 Pa. St. 43 (criticised, *supra* § 384).

By some authorities the rule has been laid down so broadly as apparently to exclude the possibility of any effectual disclosure unless the board of directors is independent; but such is not the law. For, if the shareholders and the public are notified of all the material circumstances of the proposed transaction, and also of the fact that the board of directors is not independent, that is sufficient disclosure.¹

If the corporation is what in England is called a "public company" — that is, a company whose securities are intended to be offered to the public — there can be no effective disclosure (in the absence of an independent board of directors) unless it is made to all intending subscribers, that is to say, to the public;² and hence, in the case of such a company, if the prospectus published by the promoters is not frank, the corporation may rescind a sale from them to it.³ If, however, the corporation is what the English term a "private company" — that is, a company whose securities are not intended for public subscription — full disclosure to all those persons who are shareholders when the transaction in question occurs will be sufficient, although there be no independent board of directors.⁴ In one English case, *In Re Ambrose Lake Tin Co.*,⁵ the whole of the original issue of capital stock was subscribed by the very promoters who were selling a mine to the company, and who therefore knew all the facts. The same promoters were also the directors. The mine was taken by the company at a great overvaluation; but it was held that the corporation, some of whose shares had passed into other hands could not compel the promoters to account for their profits on the sale; since all the existing members of the

¹ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392. (1897), A. C. 22; *Tompkins v. Sperry*, 96 Md. 560; 54 Atl. 254.

² *Hayward v. Leeson*, 176 Mass. 310, 320; 57 N. E. 656; 49 L. R. A. 725; *Pietsch v. Milbrath*, 101 N. W. 388; 123 Wisc. 647; 107 Am. St. Rep. 1017 (rehearing denied, 102 N. W. 342). Cf. *St. Louis, etc. R. R. Co. v. Tiernan*, 37 Kans. 606, 633, 634; 15 Pac. 544 (a case of a public company in the English sense); *Innes & Co.* (1903), 2 Ch. 254 (headnote inadequate); *Blum v. Whitney*, 185 N. Y. 232 (where it seems at least doubtful whether the principle was properly applied inasmuch as the disclosure to the shareholders seems not to have been frank).

But see *Garretson v. Pacific Crude Oil Co.*, 146 Cal. 184; 79 Pac. 838; *Hutchinson v. Simpson*, 92 N. Y. App. Div. 382; 87 N. Y. Supp. 369.

³ *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392. ⁵ *Ambrose Lake Tin Co.*, 14 Ch. D. 390.

⁴ *Salomon v. Salomon & Co.* D. 390.

company had complete knowledge of the circumstances; and the court intimated that the only remedy of purchasers of the shares would be by individual actions of deceit against the promoters for inducing them to purchase by a fraudulent overvaluation of the property. The decision certainly goes very far, and if it be inconsistent with the doctrine as to "public companies" laid down above, does not represent the English law. Perhaps the true distinction is that where *all* the authorized capital has been issued, the knowledge and consent of all the existing shareholders will forever prevent any complaint being made by the corporation, even though the original subscribers intended to dispose of their shares to the public;¹ but that, where only a portion of the authorized capital has been taken at the time of the transaction complained of, the knowledge and consent of all the existing shareholders will not bar a subsequent complaint by the company if the intention was that the remainder of the capital should be offered by the corporation for public subscription.² In this way the Ambrose Lake Case may be reconciled with Lagunas Case. If the promoters interested in the transaction hold, nominally, all the stock of the company, but really (as to much the larger part) as trustees for outside subscribers, a disclosure to and ratification by the promoters as shareholders will not prevent the corporation, representing the real or equitable holders of the shares — that is, the subscribers — from recovering the promoters' profits.³

§ 398. **Where Gift of Profit to Promoter is Ultra Vires of Corporation.** — Where a promoter receives a "profit" from the company as a mere gratuity, the proceeding may be *ultra vires*

¹ Accord: *Parsons v. Hayes*, 14 Abb., N. C., 419 (N. Y.); *Foster v. Seymour*, 23 Fed. 65; *Seymour v. Spring Forrest Cemetery Ass'n*, 144 N. Y. 333; 39 N. E. 365; 26 L. R. A. 859. *etc. Co. v. Bigelow*, 188 Mass. 315; 74 N. E. 653; 108 Am. St. Rep. 479. But see *Garretson v. Pacific Crude Oil Co.*, 146 Cal. 184; 79 Pac. 838; *Old Dominion Copper Co. v. Lewisohn*, 136 Fed. 915, affirmed, 148 Fed. 1020 (disapproving *Old Dominion Copper Mining, etc. Co. v. Bigelow*, *ubi supra*); *Flagler Engraving Machine Co. v. Flagler*, 19 Fed. 468.

Cf. *Tompkins v. Sperry*, 96 Md. 560; 54 Atl. 254.

But see *Fred Macey Co. v. Macey*, 143 Mich. 138; 106 N. W. 722. Cf. *Tompkins v. Sperry*, 96 Md. 560; 54 Atl. 254.

² *Pietsch v. Milbrath*, 101 N. W. 388; 123 Wisc. 647; 107 Am. St. Rep. 1017 (rehearing denied, 102 N. W. 342); *Old Dominion Copper Mining, etc. Co. v. French*, 4 Hun (N. Y.), 292; *Arnold v. Searing* (N. J. Ch.), 67 Atl. 831.

of the corporation; and therefore no amount of disclosure to the shareholders and acquiescence by them will enable the promoter to retain it.¹ Even in such cases, according to the relaxed rules of *ultra vires* prevailing in many of the United States, the unanimous consent of the shareholders would probably entitle the promoter to retain the profit.

§ 399. **Liability of Promoter to account for Property acquired on behalf of Company.** — The corporation may of course compel a promoter to account for any property which he acquires on its behalf after its incorporation. In order to reach this result, it is not necessary to resort to any peculiar principles of the law of promoters. Where, however, the purchase is made by the promoter prior to incorporation, the matter is not so simple, for there is an apparent difficulty in holding the purchase to have been made on behalf of a corporation which the promoters were under no obligation to form. Nevertheless, it is submitted that the company when incorporated, especially if third persons are interested in it as shareholders, should be entitled to the property on the ground that its corporate existence for this purpose relates back to the original purchase by the promoters. Accordingly, it has been held that where a promoter purchases property on behalf of the as yet unborn company, the corporation when formed may treat the purchase as made on its behalf and may require the promoter to convey the property to it.² In most of the cases of this sort, the promoter has subsequently sold the property to the company at an advance and the company has sought to recover his profit on the resale.³ But, as just stated, the same principle applies if the promoter attempts to hold the property as his own. Where promoters transfer to the corporation an option held by them for the purchase of certain real estate,

¹ *Mann v. Edinburgh Northern Tramways Co.* (1893), A. C. 69. 822, 825 (where the doctrines advocated in the text were approved

² *Seacoast R. R. Co. v. Wood*, 56 Atl. 337; 65 N. J. Eq. 530; *Central Trust Co. v. Lappe* (Pa.), 65 Atl. 1111. by Wright, J., in the Chancery Division but questioned by the judges of the Court of Appeal on appeal).

Cf. *Leeds & Hanley Theatres* (1902), 2 Ch. 809, 813-814, 821-³ See *supra*, § 384.

and the corporation allows the option to expire, the promoters are at liberty, it has been held, to purchase the property on their own account.¹

§ 400-§ 402. *Liability of Promoters in Damages for Breach of Fiduciary Duty to Company.*

§ 400. **In general.** — The third consequence of the principle that promoters occupy a fiduciary relation towards the company is that for any breach of the equitable obligations which attach to such a relationship the promoters are liable in damages. This liability is in the nature of a liability for a breach of trust or for an "equitable tort." Naturally, the liability cannot be founded merely on transactions which occurred prior to the incorporation of the company; but if after incorporation the promoters conduct themselves in a way which is inconsistent with their duties as above outlined they subject themselves to this liability. As pointed out above, promoters are under no duty of taking care for the interests of the unborn or infant company. They are entirely at liberty to dissociate themselves from the enterprise and let it drift to ruin. On the other hand, they may be guilty of an equitable tort if they intermeddle in the enterprise. This doctrine, which, although not often invoked, may nevertheless in many cases furnish a valuable resource to corporations, should not be confused with the ordinary rules of the common law as to liability for torts, such as deceit or fraud. The liability is a peculiar one dependent entirely on the fiduciary relation of the promoters and is additional to the liability for torts which are independent of that relationship.

§ 401. **Examples.** — Thus, where promoters sell property to the company through their own nominees or tools as directors, if the prospectus which is issued to the public to induce subscriptions to its shares contain misrepresentations, the promoters cannot exculpate themselves by disclosing all the material facts to the dummy directors; and consequently, as we have seen, the company may in such a case rescind the contract or, at least according to the better view, affirm it and require the promoters

¹ *Gillett v. Dodge* (Oreg.), 89 Pac. 741.

to account for their profits; but if both of these remedies are for any reason impracticable, or if for any cause the company prefer a different remedy, the promoters are liable in damages for breach of their fiduciary duty.¹ It will be observed that in such a case, even if the misrepresentations in the prospectus were fraudulent, the common law action of deceit would not lie by the company against the promoters; for disclosure having been made to the dummy directors who acted for the company in the transaction, it could not be maintained that the company relied upon the representations, so that the only liability of the promoters for deceit would be to the individual subscribers for shares, who relied upon the prospectus. Upon the same principle, if promoters sell property to the company without disclosing some material fact — such as the price at which they themselves had purchased — but without any actual misrepresentation, although an action of deceit would not lie against them because they were guilty of no actual misrepresentation, yet having violated their equitable fiduciary duty, which required the utmost frankness — *uberrima fides* — they are liable to the company in damages as for an equitable tort.²

§ 402. **Liability assimilated to Liability for Torts — Non-joinder of Defendants.** — Inasmuch as this liability of promoters for a breach of their equitable fiduciary duty is deemed an “equitable tort,” it is assimilated as far as possible to liability for common law torts. Hence, a bill in equity to enforce such a liability will lie against one of the promoters without joining as

¹ *Leeds & Hanley Theatres* (1902), 2 Ch. 809 (note, that although the liability of the promoters was frequently denominated by the court a liability to the company for its damages, yet in speaking of the amount of recovery the court said [p. 833] that “the measure of damages is the amount of profit which was made by” the promoters, so that some doubt may be felt whether after all the court does not really decide merely that the promoters must account for their profits, which if their original purchase could not be deemed to have

been made on behalf of the company would be the difference between the actual value of the property sold and the price paid therefor by the company).

² *Old Dominion Copper Mining, etc. Co. v. Bigelow*, 188 Mass. 315; 74 N. E. 653; 108 Am. St. Rep. 479 (note that the company had offered to restore the property to the promoters); *Lagunas Nitrate Co. v. Lagunas Syndicate* (1899), 2 Ch. 392 (where the right to rescind the transaction had been lost by laches).

defendants others who were jointly implicated with him in the wrong.¹

§ 403. **Penal Liability of Promoters to Company.** — Promoters who act fraudulently, or otherwise contrary to law, may incur statutory penalties, for which the statutes of each jurisdiction must be consulted; but even in the absence of express statute they have been held subject to one disability which can properly be deemed naught but a penalty for misconduct. The rule is thus laid down in the leading case: "If the promoter of a company procures a company to be formed by improper and fraudulent means, and for the purpose of securing a profit to himself, which, if the company was successful, it would be unjust and unequitable to allow him to retain, and the company proves abortive and is ordered to be wound up without doing any business, the promoter cannot be allowed to prove against the company in the winding-up, either in respect to his services in forming the company, or in respect to his services as an officer of the company after the company was registered."² This rule, if indeed it be universally accepted, does not seem to have attracted the attention one would have anticipated.

§ 404—§ 411. LIABILITIES OF PROMOTERS TO ONE ANOTHER.

§ 404. **Classification.** — The liabilities of promoters to one another may be divided into three classes: (1) liability to account for profits, (2) liability to contribute to losses and expenses, and (3) liability upon express contracts.

§ 405—§ 408. *Accountability for Profits.*

§ 405. **In general — Fiduciary Relation of Promoters to One Another.** — Upon ordinary principles of equity, promoters occupy a fiduciary relation to their associates or co-promoters,³ as well as to the company, and therefore they must account to their fellows for any profits made on this joint enterprise and

¹ *Old Dominion Copper Mining, etc. Co. v. Bigelow*, 188 Mass. 315, Ch. D. 621, 626-627. 328-329 (headnote misleading); 74 N. E. 653; 108 Am. St. Rep. 479. ² *Hereford, etc. Waggon Co.*, 2 Ch. D. 621, 626-627. ³ Cf. *Spier v. Hyde*, 92 N. Y. App. Div. 467; 87 N. Y. Supp. 285.

not disclosed to them. This is true although promoters are not partners.¹ If the profit in question be disclosed *to the corporation*, but not to the co-promoters, the latter may demand their share therein. If, however, the profit be not disclosed to the company, then on the principles considered above, it belongs to the corporation, which may recover it from the misconducting promoters; and this right of the corporation seems clearly to exclude any right of the other promoters thereto. As the whole profit belongs to the company, the courts ought not to be concerned with enforcing an equal division thereof among the several promoters. In cases of this sort, however, some high authorities have directed an accounting between the several promoters.²

§ 406. **Lungren v. Pennell.** — A Pennsylvania case affords a neat illustration of the limits of the doctrine that promoters occupy a fiduciary relation to each other. The owners of real estate sold to various persons equal undivided eighty-fourth shares therein, and subsequently, together with the purchasers, organized a corporation to take over the property. The Supreme Court of Pennsylvania held that the vendors occupied no fiduciary relation towards the purchasers of the undivided shares, and were therefore under no legal obligation to make disclosure to them.³ This decision seems clearly sound, since the only fiduciary relation was that of all the parties — vendors and purchasers — to the company.

§ 407. **Deducting from Profit Expenses incurred for Benefit of all Promoters.** — As there is no implied agency among promoters, it follows that a promoter who has transferred property to his associates under an agreement that the property so transferred together with other property shall be assigned over to the corporation in exchange for bonds and shares which shall thereupon be divisible among the promoters according to a fixed proportion, even upon the occurrence of an emergency necessitat-

¹ Cf. *Boice v. Jones*, 106 N. Y. App. Div. 547; 94 N. Y. Supp. 896. *Franey v. Warner*, 96 Wisc. 222; 71 N. W. 81 (where the plaintiffs were

But see *Schantz v. Oakman*, 10 N. Y. App. Div. 151; 41 N. Y. Supp. 746. clearly entitled to recover from defendants damages as in the common law action for deceit).

² *Emery v. Parrott*, 107 Mass. 95; *Cf. Boice v. Jones*, 106 N. Y. App. Div. 547; 94 N. Y. Supp. 896. *Dole v. Wooldredge*, 135 Mass. 140;

Getty v. Devlin, 54 N. Y. 403, and ³ *Lungren v. Pennell*, 10 W. N. C. (on subsequent appeal) 70 N. Y. 504; (Pa.) 297.

ing a borrowing of money in order to prevent a failure of the enterprise, the promoters have no right to use any of the stocks and bonds in securing such a loan, and therefore they must account to the transferor for his full proportion of the securities without deduction for any which they have used in procuring the loan.¹

§ 408. **Termination of Fiduciary Relation — Abandonment of Enterprise.** — If the scheme of promotion is by common consent abandoned, any of the promoters is entitled subsequently to organize a new scheme for the formation of a company; and in the new scheme he may avail himself of the efforts of his associates in the abandoned enterprise without incurring any liability to account to them for his profits on the new enterprise.²

§ 409. **Contribution to Losses and Expenses.** — Where promoters have incurred expenses in the prosecution of the enterprise, all those who have concurred in the expenditure or in the contracting of the debt are bound to contribute to the payment, each one bearing his proportionate part measured by the number of persons so liable;³ and, since such joint contractors are not partners, one of them, paying the whole debt, may enforce his right to contribution in an action at law,⁴ although he may at his election proceed in equity.⁵ Where the promoters have become liable on a covenant to pay rent, contribution may be enforced against one of their number who has severed his connection with the project before the rent in question accrued.⁶ Under some circumstances, a promoter who would not be directly liable to the other party to the contract may be called upon by co-promoters for contribution.⁷

¹ *McNeil v. Fultz*, 38 Can. Sup. Ct. 198.

² *Parks v. Gates*, 84 N. Y. App. Div. 534; 82 N. Y. Supp. 1070.

³ *Batard v. Hawes*, 2 E. & B. 287; *Sandusky Coal Co. v. Walker*, 27 Ont. 677; *Lefroy v. Gore*, 1 Jo. & Lat. 571, 582.

⁴ *Batard v. Hawes*, 2 E. & B. 287. Cf. *Denton v. Macniel*, 2 Eq. 352.

But see *Crow v. Green*, 111 Pa. St. 637, 641; 5 Atl. 23.

⁵ *Lefroy v. Gore*, 1 Jo. & Lat. 571, 582.

⁶ *Boulter v. Peplow*, 9 C. B. 493.

⁷ *Norbury's Case*, 5 De G. & Sm. 423; *Spottiswoode's Case*, 6 De G. M. & G. 345, 371.

But see *Lefroy v. Gore*, 1 Jo. & Lat. 571, 581.

§ 410-§ 411. *Liability on actual Contracts between Promoters.*

§ 410. **Liability on Contract to form Corporation.** — Often, indeed usually, promoters either expressly or impliedly contract between themselves to form the corporation. Such a contract, however, involving as it necessarily does the performance of a succession of acts, cannot be specifically enforced in equity.¹ No chancellor could undertake to supervise the complicated questions of policy that arise in the organization of a corporation. On the other hand, where two promoters, A and B, agreed together that A should acquire title to certain land to be conveyed to the projected corporation in exchange for its entire capital stock, part of which was to be transferred to B, and where after the corporation was formed and its stock issued to A, he refused to convey the real estate to the corporation or to transfer to B the shares due him under the agreement, it was held that a person claiming by assignment under B might maintain a suit for specific performance against A to compel him to convey the land to the company and to transfer the stock to B's assignees.² It was further held that such a suit is not a shareholder's suit based upon equitable ownership of the stock and filed in the right of the corporation, but is founded upon B's individual rights under the contract, so that although the corporation was a proper party defendant yet its joinder as defendant did not oust the jurisdiction of a federal court, which was invoked on the ground of diverse citizenship, although the corporation was formed under the laws of the state of which some of the plaintiffs were citizens.³

§ 411. **Effect of Illegal Features of projected Corporation upon Legality of Contracts between Promoters.** — In the course of the promotion of a corporation, promoters may enter into many contracts or agreements *inter sese* which are governed by the principles of the law of contracts. The circumstance that such contracts contemplate the incorporation of a company in

¹ *Henreich v. Lidberg*, 105 Ill. App. 495; *Rudiger v. Coleman*, 112 N. Y. App. Div. 279.

Cf. *Stocker v. Wedderburn*, 3 K. & J. 393.

² *Rogers v. Penobscot Mining Co.*, 154 Fed. 606.

³ *Rogers v. Penobscot Mining Co.*,

no manner affects the rules of law which apply to them.¹ If, however, the scheme of the projected corporation is unlawful, such contracts may be tainted by the illegality, and on that account be unenforceable. For example, where promoters agreed with certain brokers that the latter should sell some bonds of the projected company and should receive in compensation for their services in the sale of the bonds and organization of the company an amount of stock the par value of which exceeded the market value of such services, the court held that the contract was illegal under a state constitution which forbade either property or labor to be received in payment for stock at a greater value than the market price, and that consequently, upon the abandonment of the enterprise by the promoters, the brokers could not maintain an action for damages.² On the other hand, an agreement between promoters for the formation of a corporation will not generally be deemed illegal or contrary to public policy because it may fix the price at which certain property is to be transferred to the company in payment for shares,³ unless there be affirmative proof that the valuation was fraudulently excessive.

§ 412-§ 415. *Liability of Promoters to individual Shareholders and Subscribers to Shares.*

§ 412. **Subscribers to Shares as Promoters.** — In one sense, every subscriber to shares in a projected corporation is a promoter. Hence the liabilities of promoters to subscribers to shares may properly be considered under the general head of liabilities of promoters to one another. Nevertheless, it should be observed that it is the act of subscribing to shares which makes the subscribers co-promoters. Prior to that time, they were strangers to the enterprise.

§ 413. **Whether Promoters occupy Fiduciary Relation to Subscribers — Liability for Non-disclosure.** — In some cases, it has

¹ Cf. *A. J. Cranor Co. v. Miller* (Ala.), 41 So. 678 (where the contract was rescinded for fraud).

² *Altenberg v. Grant*, 85 Fed. 345; 29 C. C. A. 185.

Cf. *Garrett v. Kansas City Coal Mining Co.*, 113 Mo. 330; 20 S. W. 965; 35 Am. St. Rep. 713.

³ *Lorillard v. Clyde*, 86 N. Y. 384; *Electric Fireproofing Co. v. Smith*, 113 N. Y. App. Div. 615, 621.

Cf. *Arnold v. Searing* (N. J. Ch.), 67 Atl. 831.

been said,¹ and in others held,² that promoters occupy a fiduciary relation towards the subscribers to shares in the company being promoted, and that therefore they are bound to disclose to them all material circumstances, and will be liable to them in case of failure so to do. But in general, according to the weight of authority, promoters occupy no fiduciary relation towards individual shareholders, to whom, therefore, their liabilities must be worked out on the ordinary principles of the law of torts. Hence, they are not responsible to an individual shareholder for a mere failure to disclose material facts, nor for misrepresentations made with an honest belief in their truth.³ This latter consequence of the doctrine that promoters occupy no fiduciary relation towards subscribers to shares has been abrogated in England by the Directors' Liability Act of 1890.⁴ Moreover, in certain cases of non-disclosure without actual misrepresentation, promoters were made liable to subscribers to shares by § 39 of the Companies Act of 1867;⁵ but by the Companies Act of 1900 this section has been repealed.⁶

§ 414. **Assumption by Promoters of Fiduciary Relation to Shareholders.** — Of course, the individual shareholders may voluntarily constitute the promoters their agents or trustees, and if so, the latter then occupy towards them a fiduciary relation. Thus in *Williamson v. Krohn*,⁷ certain promoters, being the holders of all the shares in a bridge company, agreed with the plaintiff for a consideration to give him an interest of eight per cent in the enterprise. Subsequently, they entered into a contract with a construction company by which the latter agreed to build the bridge in consideration of a transfer to it of all the stock of the bridge company and a large amount of its bonds. The contract further stipulated that the construction company should return \$200,000 worth of the stock to the promoters. By a con-

¹ *Short v. Stevenson*, 63 Pa. St. 95; *Teachout v. Van Hoesen*, 76 Iowa 113; 40 N. W. 96; 14 Am. St. Rep. 206; 1 L. R. A. 664.

² *Brewster v. Hatch*, 122 N. Y. 349; 25 N. E. 505; 19 Am. St. Rep. 498; *Goodwin v. Wilbur*, 104 Ill. App. 45.

³ *Derry v. Peek*, 14 A. C. 337. Cf. *Duryea v. Zimmerman*, 106 N. Y. Supp. 237.

⁴ 53 & 54 Vict., c. 64.

⁵ 30 & 31 Vict., c. 131, § 138.

See *Cackett v. Keswick* (1902), 2 Ch. 456.

⁶ 63 & 64 Vict., c. 48, § 33. See also § 9 and § 10.

⁷ *Williamson v. Krohn*, 66 Fed. 655; 13 C. C. A. 668, affirming s. c. 62 Fed. 869.

temporaneous agreement between the promoters and the construction company, the former undertook to procure the necessary land for approaches to the bridge in consideration of \$300,000 in cash and \$600,000 in the bridge company's shares. The cash portion of this premium was in fact ample, and was so regarded by the parties at the time, for the purpose of buying the land. The existence of the second contract was not disclosed to the plaintiff, who was given eight per cent of the stock returned to the promoters under the contract, as the full extent of his rights. On discovery of the facts, the plaintiff filed a bill against the promoters for an accounting for eight per cent of the stock acquired by them under the second contract. The court held that the promoters were his trustees or agents in respect to the eight per cent interest in the stock which they had agreed to give him, that this profit had been acquired by them by dealing with this stock, and should have been disclosed to the plaintiff, and that accordingly he was entitled to the relief prayed. That the promoters did occupy a fiduciary relation to the plaintiff was apparent, and that they had grossly violated their duty to him was equally patent. The only difficulty in the case was to determine what part of the secret profits belonged to the plaintiff and what part to the corporation. That the plaintiff was entitled to some portion of it, no one would question.

§ 415. **Liability for Return of Subscribers' Deposits upon Abandonment of Enterprise.**—In some cases promoters prior to the incorporation of the company receive subscriptions to its shares and accept deposits from the subscribers. Under such circumstances, if the scheme prove abortive, the corporation never being organized, the subscribers may by action at law recover back their deposits from the persons by whom they were received;¹ but no such recovery can be had if the moneys have been applied in furtherance of the scheme either under the terms of the subscription contract² or with the acquiescence of the

¹ *Walstab v. Spottiswoode*, 15 M. & W. 501; *Ashpitel v. Sercombe*, 19 L. J. Ex. 82; *Nockells v. Crosby*, 3 B. & C. 814; *Hayes v. Stirling*, 14 Ir. C. L. Rep. 277; *Hudson v. West*, 189 Pa. St. 491; 42 Atl. 190; *Fitzwilliam v. Travis*, 65 Ill. App. 183 (semble).
² *Garwood v. Ede*, 1 Ex. 264; *Jones v. Harrison*, 2 Ex. 52; *Willey v. Parratt*, 3 Ex. 211; *Baird v. Ross*, 2 Macq. H. L. 60, 68-69; *Watts v. Salter*, 10 C. B. 477. Cf. *Vane v. Cobbold*, 1 Ex. 798, where the subscriber alleged, but failed to prove, that his payment of

subscribers.¹ Where the promoters are authorized to expend the deposits in furthering the project, their authority to do so cannot be revoked by a discontented subscriber, so as to entitle him to recover his deposit without deductions for subsequent expenditures by the promoters.² Of course, by special contract a promoter may agree to return a deposit without deduction if the scheme prove abortive, although by the terms of the general agreement among the subscribers the expenditure of the deposits for the promotion of the company is authorized.³ One promoter is not liable for the return of deposits received by other promoters,⁴ unless the latter are his duly authorized agents. A complete change in the nature of the projected incorporation is clearly a sufficient abandonment of the scheme to entitle the subscribers to recover back their deposits.⁵ And if no time is fixed for the completion of the incorporation, the subscriber is entitled to treat the scheme as abandoned unless the company is formed within a reasonable time.⁶ If the project was a mere fraud or bubble, the deposits may be recovered in equity;⁷ and suits in equity have been maintained by one subscriber on behalf of himself and all others to require the promoters to account for the deposits.⁸ But in case of abandonment of a *bona fide* scheme, it seems that in general the subscriber's only remedy is at law.⁹ Very clearly, all the subscribers must be treated equally, and a court of equity will require the promoters to turn the deposits *pro rata* without preferring any subscriber or class

the deposit had been induced by fraud of the promoters.

¹ *Ashpitel v. Sercombe*, 19 L. J. Ex. 82 (semble).

² *Baird v. Ross*, 2 Macq. H. L. 61.

³ *Mowatt v. Londesborough*, 4 E. & B. 1.

⁴ *Burnside v. Dayrell*, 3 Ex. 224.

See also *Hayes v. Stirling*, 14 Ir. C. L. Rep. 277; *Fitzwilliam v. Travis*, 65 Ill. App. 183.

⁵ *Hayes v. Stirling*, 14 Ir. C. L. Rep. 277, 282-283.

⁶ *Hudson v. West*, 189 Pa. St. 491, 495; 42 Atl. 190.

See further as to evidence of abandonment, *Chaplin v. Clarke*, 4 Ex. 402.

⁷ *Green v. Barrett*, 1 Simons 45; *Cridland v. De Mauley*, 1 De G. & S.

459.

⁸ *Clements v. Bowes*, 17 Simons 167, 1 Drewry 684 (headnote misleading); *Williams v. Page*, 24 Beav. 654.

But see *Williams v. Salmond*, 2 Kay & J. 463; *Moseley v. Cressey's Co.*, 1 Eq. 405 (semble).

Cf. *Bosher v. Land Co.*, 89 Va. 455; 16 S. E. 360; 37 Am. St. Rep. 879 (where the company had been incorporated).

⁹ See *Denton v. Macniel*, 2 Eq. 352; *Stewart v. Austin*, 3 Eq. 299.

But see *Apperly v. Page*, 1 Phill. Ch. 779.

of subscribers.¹ So, promoters may be enjoined from misapplying deposits paid by intending shareholders even though the proposed form of the intended company be legally impossible.² Although it be expressly stipulated that deposits shall be returned unless shares are allotted, yet if the moneys received are placed in bank to the company's credit the latter on its incorporation will not be enjoined from dealing with them as its own; the depositors have no lien on the deposits, and their remedy, and only remedy, is, in case of no allotment being made, by an action against the promoters for money had and received.³ If the promoters misapply the deposit, the applicant for shares cannot, on abandonment of the projected incorporation, treat the deposited moneys as a trust fund capable of being followed in equity.⁴ If a subscriber to shares has agreed to pay a deposit but has not actually done so, an abandonment of the project before the company is incorporated relieves him from the obligation to pay the deposit.⁵

¹ *Williams v. Page*, 24 Beav. 654, 663-664.

² *Butt v. Monteaux*, 1 K. & J. 98.

³ *Moseley v. Cressey's Co.*, 1 Eq. 405.

⁴ *Stewart v. Austin*, 3 Eq. 299.

⁵ *Capper's Case*, 1 Sim., N. S., 178; *Bradford v. Harris*, 77 Md. 153; 26 Atl. 186.

But see *Aldham v. Brown*, 7 E. & B. 164; 2 E. & E. 398.

CHAPTER VII

UNDERWRITING

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§ 416. **Application of Principle of Insurance to Promotion of Corporations.** — One of the modern devices by which the promotion or “flotation” of a corporation is nowadays generally facilitated is the underwriting of its securities. Business men are wisely sensible of the advantage of insuring against all possible risks and uncertainties; and consequently recent years have witnessed enormous extensions in the application of the principle of insurance. In respect to the promotion of corporations, this fact is illustrated by the growth of the practice of underwriting securities.

§ 417. *Risks insured against by Underwriting Agreements.* — When any corporate enterprise is launched, the most immediate object of solicitude to the promoters is the procurement of subscriptions to the shares, bonds, debentures, or other securities that may be put upon the market. Prospectuses are published, and all the other familiar and elaborate advertising devices are resorted to for the purpose of inducing the public to subscribe. But in spite of such efforts, accidental circumstances — a rumor of war, the circulation of a false report as to the company's prospects, or any one of a thousand similar accidents — may defeat the best grounded expectations and prevent the successful marketing of the company's securities. The promoters will naturally exert themselves to prevent such a frustration of their plans; and if skilled financiers are included among their number, they are apt to be measurably successful. But the possibility of failure in this endeavor to float the securities can be reduced to a minimum if only some responsible person or persons can be found who, for a consideration, a commission, or premium, will guarantee that the securities or some part of them shall be taken by the public before a certain date, and will agree to take any that may not be subscribed by the public before that time. Such an agreement is called an underwriting agreement.

§ 418. *Advantages of Underwriting to Persons interested in the Company.* — Frequently, underwriting is done by a banker or finance company¹ not previously interested in the promotion of the new enterprise. In such cases, in consideration of the payment of a premium, or of a promise to pay a commission on, or a comparatively small proportion of, the price obtained by the company for any of the securities taken by the public, the promoters are assured that their undertaking will not perish for want of the funds calculated to be necessary for its initiation. In addition to this, the underwriters, who are necessarily men of large means, and are usually financiers of ability and repute, are thereby interested in the success of the undertaking. It is often no small advantage to the promoters to be able merely to point to men of that class as associated with the enterprise. Their very names may inspire confidence. Then also, to enlist on the side of the infant corporation the sympathies and advice and assistance of men of skill and experience in financial affairs is often a very real benefit. All these circumstances combine to justify the promoters and the corporation, as a matter of practical business, — the legality of the course will be considered below, — in paying large sums to the underwriters.

§ 419. *Definition of Underwriting as applied to Shares, Bonds, etc.* — Underwriting agreements may take a variety of forms; but before considering the several kinds of underwriting contracts, it is proper to examine the authorities which define what underwriting is. An underwriting agreement, in the law of corporations, may be defined as an agreement to take such part of a specified number of shares, bonds, or other securities as may not be subscribed for by the public before a specified date.² An

¹ As to the power of a trust company to act as underwriter, see *Gause v. Commonwealth Trust Co.*, 106 N. Y. Supp. 288, 291 (a decision which tends to deny the existence of the power).

² *Ex parte Audain*, 42 Ch. D. 1. Said Cotton, L. J.: "An 'underwriting' agreement means an agreement entered into before the shares are brought before the public, that in the event of the public not taking up the whole of them, or the num-

ber mentioned in the agreement, the underwriter will, for an agreed commission, take an allotment of such part of the shares as the public has not applied for." 42 Ch. D. 6. See also *London Paris Financial, etc. Corp.*, 13 Times L. R. 569. Said Lindley, L. J.: "To underwrite as applied to shares means to take and pay for them if the public do not." 13 Times L. R. 570. Said Ludlow, L. J.: "To underwrite means to take and pay for shares

agreement underwriting shares must be distinguished from an agreement to "place" a certain number of shares or to guarantee that a certain number of shares will be taken by the public. A person who underwrites shares becomes bound himself to take the shares if the public do not; and the company may accordingly in that contingency place his name upon the list of shareholders and hold him as a shareholder.¹ But a mere guarantee that shares shall be taken by the public subjects the guarantor to no such liability.² The only claim against him is for breach of an ordinary contract which is not governed by the peculiar principles applicable to agreements to take shares; for example, the guarantor may raise the defence of fraud in cases where that defence would not be open to a subscriber to shares.³

§ 420-§ 422. *Parties to Underwriting Agreements.*

§ 420. **Agreements between the Underwriter and the Company.**—An underwriting agreement is a contract, and like other contracts it must be between definite parties. When the underwriting takes place after the incorporation of the company, the agreement may be made between the company of the one part and the underwriter of the other. This is a simple method, and accomplishes the desired result in that the corporation, being a party to the agreement, has the legal right to enforce it.

§ 421. **Agreements of Underwriters Inter Sese and with Trustee for Corporation or projected Corporation.**—This simple scheme is not feasible where, as is usually the case when a new enterprise is launched, the underwriting takes place prior to incorporation. Under those circumstances, in the United States, a practice is for the underwriters to sign a contract in which they purport to agree, each for himself, with a trustee for the proposed corporation, and to and with each other. The legal effect of such a contract is involved in some obscurity. The

if other persons do not, and other persons *prima facie* means the public." 13 Times L. R. 571.

¹ *Ex parte Audain*, 42 Ch. D. 1. Cf. *Re Hooley* (1899), 2 Q. B. 579.

² *Gorriessen's Case*, 8 Ch. 507.

³ *Gorriessen's Case*, 8 Ch. 507, 516. As to how far this defence of fraud is available to an underwriter, see *infra*, § 438 and § 441.

matter has never been judicially determined in this country.¹ Undoubtedly, the courts would strive to uphold the agreement, and to carry it out according to the intention of its framers; and this endeavor would be facilitated by the somewhat loose doctrines which have been established in many states as to the right of a stranger to a contract to enforce performance. Nevertheless, the lawyers who conduct such enterprises should recognize that the enforceability of many American underwriting agreements according to their tenor is by no means as free from technical legal objections as could be desired in the case of instruments involving, sometimes, many millions of dollars. The corporation, not being in existence, cannot be bound by the agreement² and might have difficulty in taking advantage thereof.³ Probably, some way would be found to surmount these and all other difficulties, but the element of uncertainty cannot be said to be wholly lacking. In one case where an underwriting agreement was made between a company described as "syndicate managers" and the several underwriters, a provision in the agreement whereby the several underwriters agreed to guarantee the payment of a loan to be made by a trust company to the "syndicate managers" was enforced at the suit of the trust company which made the loan.⁴

§ 422. **Device for enabling Company to take Advantage of Underwriting Agreement to which it is not Party.** — In England, where the rule is strictly adhered to that a contract cannot be enforced by a stranger thereto, these difficulties adverted to in the last paragraph would be far more formidable. Accordingly, an expedient has been devised which may be worthy of imitation by American lawyers. The underwriting agreement is made between the underwriter and the leading promoter of the intended company, generally taking the form of a printed letter addressed by the underwriter to the promoter and by him accepted at the foot or end thereof by signing a printed acceptance.⁵ By the agreement the underwriter constitutes and

¹ Compare, however, *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306, 311.

² *Supra*, § 323 et seq.

³ *Supra*, § 350.

⁴ *Knickerbocker Trust Co. v. Davis*, 143 Fed. 587.

⁵ For form of such an underwriting letter and acceptance, see Hamilton's *Manual of Company Law*, 2d ed., pp. 75 et seq.; Palmer's *Company Precedents*, 9th ed., 241

et seq.

appoints the vendor or promoter his attorney to apply for and accept, on his behalf, the shares or bonds underwritten, in case the contingency arises in which by the terms of the agreement he is bound to take them. By means of this power of attorney, as we shall presently see, the person designated as attorney is able at any time to apply for and accept on behalf of the underwriter the securities which the latter may become bound to take. The company although not a party to the underwriting agreement is enabled, with the co-operation of the attorney, to secure for itself the same rights as if it had been a party. Moreover, any necessity for a suit for specific performance of the agreement is obviated: the attorney simply performs it on behalf of the underwriter.

§ 423. **Other and Miscellaneous Kinds of Underwriting Agreements.** — Still other forms of real or so-called underwriting agreements are sometimes encountered. Sometimes the so-called underwriter subscribes absolutely for the securities in question, with the idea that he himself will “unload” them on the public as best he may. Obviously, such an agreement is not properly a contract of underwriting or insurance, and does not differ, legally, from any other subscription to bonds or shares. A recent Connecticut case discloses a still different form of “underwriting.” There, each “underwriter” signed a so-called “underwriter’s certificate” whereby he promised to pay a certain sum of money to a payee named therein or his order, upon delivery of a certain amount of stock and bonds of a certain corporation.¹ In the case referred to, the court held that no tender of the stock and bonds had been proved sufficient to hold the “underwriter.” Obviously, such an agreement is not underwriting in any proper sense of the word. Indeed, as such an instrument is certainly not a negotiable note, its enforcement would be likely to encounter many obstacles, some of which will readily occur to any lawyer.

¹ *Litchfield Sav. Soc. v. Dibble* (Conn.), 67 Atl. 476.

§ 424—§ 426. *Acceptance of Offer to Underwrite Securities.*

§ 424. **Necessity for Acceptance.** — An offer to underwrite shares, bonds, or other securities, like any other offer, should regularly be accepted by the other party to the intended contract before the offerer becomes bound. When the underwriting agreement is made prior to incorporation in the somewhat anomalous form which is not uncommon in America and which has already been described,¹ considerable difficulty might be experienced in determining who constitutes the other party to the proposed contract by whom the underwriting offers should be accepted. In practice, each underwriter signs a certain printed form which contains a clause stating that the agreement shall be binding as soon as a certain proportion of the securities shall be underwritten; and no further acceptance is contemplated. Whether or not this intention that the agreement shall thenceforward be binding will be effectuated by the law is a question to which reference has already been made.² But wherever the underwriting agreement is not in this anomalous shape, but where an offer to underwrite securities is made to a corporation or to some vendor or promoter, the offer will not be binding until it is accepted by the corporation or other person to whom it is addressed.³ This is true although the offer may purport to be a contract, using terms such as “agree,” “engagement,” etc., which are properly applicable to a completed contract rather than a mere open offer.⁴ This circumstance accentuates the

¹ Supra, § 421.

² Supra, § 421. Cf. *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306, 311, where the court distinguished an agreement of underwriting made with the corporation itself from an agreement made with a person who had himself underwritten the shares — a contract of reinsurance — and held that the latter form of agreement, being entered into by the reinsurers at the solicitation of the first underwriter, required no further acceptance to make it binding. It is submitted that the crucial point was not that the proposition of the reinsurers was made to the first underwriter

rather than to the company, but that having been made at the offeree's solicitation, it was then and there impliedly accepted by the person to whom it was addressed.

³ *Gutta Percha Corp.*, 15 Times L. R. 183; *Ex parte Stark* (1897), 1 Ch. 575.

But see *Ex parte Harrison*, 69 L. T. 204 (as to which case, see explanation of Smith, L. J., in *Ex parte Stark* (1897), 1 Ch. 575, 596–597).

Cf. *North Charterland Exploration Co. v. Riordan*, 13 Times L. R. 80 (where a written offer was accepted orally).

⁴ *Hindley's Case* (1896), 2 Ch. 121, 129, 133 (headnote inadequate).

doubt whether an American underwriting "agreement" would not be held to be a mere offer until accepted by some one to whom the underwriter could look for his compensation or commission.

§ 425. **What amounts to Acceptance.** — The acceptance may be oral although the offer be in writing, and may be implied from conduct. Thus, where the underwriter handed his proposition in writing to the secretary of the company to whom it was addressed, the court inferred an acceptance by the secretary from his mere receipt of the paper without objection and placing it on the list of underwriting offers.¹

§ 426. **Time of Acceptance.** — The acceptance of an underwriting offer must be made and communicated to the underwriter within the time, if any, limited and specified for that purpose in the offer; and if no time be expressed, then within a reasonable time. Inasmuch as the underwriter's obligation is to subscribe for such of the shares, bonds, or other securities underwritten as may not be taken up by the public before a certain named date, and therefore partakes of the nature of a wager upon the amount which the public will subscribe, fairness to the underwriter requires that his offer should be accepted before that date. The company should not be permitted to lie by until the offer to the public has proved a failure, and then accept the underwriter's proposition. No one would say that an offer to insure a building against fire for the period of a year could be accepted after the year has elapsed and after the building has burned down; and the principle is similar in the case of an offer to insure the public subscription of corporate securities. Hence, a proposition to underwrite shares, bonds, or other securities must in general be accepted by the opposite party before the close of the time within which the securities are to be offered to the public.² Still, this rule is not invariable; for while underwriting agreements do have some elements of wagers, yet they are not mere bets.³ At any rate, if the offer to underwrite by its

¹ *North Charterland Exploration* (Mass.), 81 N. E. 306 (explained *Co. v. Riordan*, 13 Times L. R. 80 *supra*, p. 350 n. 2). and 281.

² *Ex parte Stark* (1897), 1 Ch. Cf. *Bultfontein Sun Diamond* 575. But see *Dadson's Case*, 12 Mine, 12 Times L. R. 461, 462 Times L. R. 482.

(affirmed in 13 Times L. R. 156); ³ *Ex parte Stark* (1897), 1 Ch. *Electric Welding Co. v. Prince* 575, 592.

terms is to remain open for a certain length of time, it may be accepted at any time within that period even after the securities have been offered to the public.¹

§ 427-§ 430. *The Consideration for Underwriting.*

§ 427. **Nature of the Consideration.** — The consideration for underwriting may, in theory, be any consideration sufficient to support an assumpsit.² In England, the consideration is usually the promise of the company, or of the promoter with whom the underwriting agreement is made, to pay to the underwriter a premium in the shape of a commission at a certain rate per cent on the par value of the shares or securities underwritten, this commission being payable whether the shares or securities be taken by the public or whether the underwriter is compelled to take them.³ Sometimes, a person who is interested as a shareholder in the company will agree to transfer to the underwriters some of his shares as a consideration or bonus for acting as underwriter.⁴ In the United States, another method of compensating the underwriter is frequently adopted. A price will be named at which the securities will be offered to the public, and a lower price at which the underwriter is to take them in case they are not subscribed by the public: the underwriter is to receive as his compensation or commission the difference between such underwriting price of any of the securities that may be subscribed by the public and the price paid by the public subscribers. In this way, the underwriter's compensation is contingent.⁵ If none of the securities underwritten are taken by the public, the underwriter will receive nothing; and the more securities the public

¹ *Hindley's Case* (1896), 2 Ch. 121.

² Cf. *London Paris Financial, etc. Corp.*, 13 Times L. R. 569 (where the consideration consisted in an option given to the underwriter of subscribing at par for the shares before they should be offered to the public). See 13 Times L. R. 570-571.

³ Cf. *Booth v. New Afrikander Gold Mining Co.* (1903), 1 Ch. 295 (as to the meaning of a provision authorizing payment of compensation to underwriters "at a rate not exceeding 50 per cent.").

⁴ Cf. *Eastern Tube Co. v. Harrison*, 140 Fed. 519.

⁵ Cf. *Philadelphia Construction Co. v. Cramp*, 138 Fed. 999 (where the court construing an underwriting agreement, held that a cash commission was to be paid to the underwriters only in case the bonds underwritten should be taken by the public, while a "bonus" in the shape of full-paid shares was to go to the underwriters in any event); *Knickerbocker Trust Co. v. Davis*, 143 Fed. 587.

subscribe for, the greater will be the underwriter's profit. The advantage, from the company's point of view, of a contingent compensation of that sort is very doubtful. It complicates the matter, and enables the underwriters in case the flotation of the company is successful to reap profits so enormous as to constitute almost a scandal.

§ 428. *By whom the Consideration is paid — In general.* — For most purposes, it is immaterial by whom the underwriter's compensation is paid, whether by the company or some vendor or other promoter.¹ If the American scheme of compensation mentioned in the last paragraph be adopted, the burden of paying the underwriter falls on the corporation. The benefits derived by the company from the underwriting of its shares, bonds, or other securities have been already mentioned,² and are so obvious that no practical business man would doubt the propriety of drawing a reasonable sum from the company's treasury for the purpose of securing them.

§ 429. *Legality of Payment by Company.* — No legal objection has ever been raised to payment by a corporation for underwriting its bonds, debentures, or other similar securities. But in the case of underwriting of shares, the contention has been made in England that for the company to pay any compensation to the underwriter would be, in effect, an issue of shares at a discount equal to the amount of such commission. A corporation, it is said, has no right to pay a person for subscribing to its shares. In one case, this contention prevailed;³ but at least one other decision is inconsistent therewith.⁴ It is submitted that the doctrine of the latter case is preferable. Very large proportions of the expenses of promotion are incurred for the purpose of inducing subscriptions to the company's shares. This is the object for which prospectuses are printed and advertisements circulated; yet who has ever questioned the right of a corporation to incur expenses for prospectuses and advertisements? Moreover, it is settled that a corporation may pay a commission

¹ *Milwaukee Cold Storage Co. v. Dexter*, 99 Wisc. 214; 70 N. W. 976; 40 L. R. A. 837 (where payment by a promoter of a sum of money to a capitalist for underwriting shares was held to be no evidence of fraud on the promoter's part).

² *Supra*, § 418.

³ *Lydney Iron Co. v. Bird*, 33 Ch. D. 85.

⁴ *Ex parte Audain*, 42 Ch. D. 1. Cf. *Ex parte Stark* (1897), 1 Ch. 575, 598.

to a broker for placing its shares.¹ If such expenses are legitimate, would it not be sticking in the bark to object to payments *bona fide* made for underwriting the company's shares? Even where the underwriter is paid in the first instance by a vendor or other promoter, the expense must ultimately be made up or recouped out of the corporation.² It is unreasonable to object to the payment being made by the corporation directly instead of indirectly. Underwriting agreements are not mere devices to enable shares to be issued at a discount. If they were, a different result would be reached. Underwriting is becoming almost as much a normal part of the promotion of a corporation as the publication of a prospectus. The application of the company's funds to that purpose ought to be legitimate; and there is no doubt that it would be so held in America. And in England, Parliament stepped in and resolved all doubts by a statute which establishes the legitimacy of reasonable *bona fide* payments by a corporation for underwriting its own shares,³ although somewhat stringent conditions and restrictions are imposed to guard against an abuse of the privilege.⁴

§ 430. **Actions or Suits by Underwriter to recover his Compensation.** — Where the underwriter's commission is to be paid by a promoter, with whom the underwriting agreement is made, the underwriter may recover his commission even though the agreement contemplated that he should make application to the company for allotment of the shares underwritten, and though no such application has in fact been made:⁵ the underwriter's breach of such a stipulation is at most ground for a cross action against him.

If the underwriting agreement contemplates a violation of law — for example, an infringement of a statute forbidding property

¹ *Metropolitan Coal, etc. Ass'n v. Scrimgeour* (1895), 2 Q. B. 604 (overruling *Faure Electric Co.*, 40 Ch. D. 141); *Ross v. Saylor*, 104 Ill. App. 19; *Bauersmith v. Extreme Gold, etc. Co.*, 146 Fed. 95 (where the company raised no objection on this score to the recovery by the broker).

² *Keatinge v. Paringa Consolidated Mines* (1902), W. N. 15 (where a commission of ninety per cent was held illegal).

³ *Ex parte Stark* (1897), 1 Ch. 575, 598. Cf. *Milwaukee Cold Storage Co. v. Dexter*, 99 Wisc. 214; 74 N. W. 976; 40 L. R. A. 837.

⁴ Companies Act, 1900 (62 & 63 Vict., c. 20), § 8.

⁵ See *Hilder v. Dexter* (1902), A. C. 474; *Burrows v. Matabele, etc. Co.* (1901), 2 Ch. 23; *Booth v. New Afrikander Gold Mining Co.* (1903), 1 Ch. 295.

⁶ *Sangster v. Netter*, 9 Times L. R. 441.

or labor to be received in payment for stock at less than its actual value — the whole contract may be tainted with illegality, so as to prevent the underwriter from maintaining an action for his agreed compensation or commission.¹

§ 431—§ 433. *The Offer of the Securities underwritten to the Public for Subscription.*

§ 431. **Necessity for Offer of the Securities to the Public.** — We have seen above that every underwriting agreement necessarily contemplates that the securities underwritten shall be offered to the public for subscription. Indeed, a contract to underwrite securities, *simpliciter*, implies that the shares must first be offered to the public; and hence the underwriter's obligation to take the shares does not arise unless they are first put on the market for public subscription, even though the circumstances were such that an offer of the shares to the public would necessarily have been futile.² It would seem that an offer of securities to some limited class of persons — for example, the shareholders in some existing company — cannot be deemed an offer of the securities to the public.³ The necessity for an offer to the public is not obviated by the fact that the underwritten shares were offered *pro rata* to the existing shareholders of the company.⁴

§ 432. **Time for Offer to the Public.** — It would seem clear that the offer to the public must take place strictly within the time limited for it in the underwriting agreement, or if no time be expressed then within a reasonable time; or else the underwriter will be discharged. The underwriter may be willing to assume the risk of a panic or "slump" in the market for a short but not for an indefinitely long period; and therefore time is of the essence of the agreement. Thus, where the underwriter contracted on the faith of a prospectus which stated, "Lists of applications will open on the — day of 1890, and will close on or before the — day of 1890," the Massachusetts Supreme Court

¹ Cf. *Allenberg v. Grant*, 85 Fed. 345; 29 C. C. A. 185.

² *Booth v. New Afrikander Gold Mining Co.* (1903), 1 Ch. 295.

³ *London Paris Financial, etc. Corp.*, 13 Times L. R. 569; *Paul Boyer, Ltd. v. Edwardes*, 17 Times L. R. 16 (headnote inadequate).

⁴ *London Paris Financial, etc. Corp.*, 13 Times L. R. 569 (headnote inadequate).

thought that the underwriter would be discharged unless the shares were offered to the public within the year 1890, or at any rate within a reasonable time, and that fifteen months was more than a reasonable time.¹ The court also thought that the existence of a panicky market which rendered impossible the successful flotation of a new company at that time would not excuse a postponement of an offer to the public.² In the same case, however, the court concluded (although they did not find it necessary to decide the point) that if the underwriter after the expiration of the time for offering the shares to the public treated his contract as still binding by acquiescing in the retention of deposits which he had made, he thereby waived the defence.³

§ 433. **What is such a Taking by Public as will discharge the Underwriter.** — In determining how many of the shares underwritten have been subscribed by the public so as to ascertain the extent of the underwriter's obligation, any shares which the underwriter may himself have subscribed "firm" — i. e., unconditionally and independently of the underwriting agreement — are to be reckoned as subscribed by the public.⁴

§ 434–§ 435. *Conditions in Underwriting Agreements.*

§ 434. **Implied Conditions.** — The courts will not read into the contract conditions which are not part of the very meaning of the term, underwrite, as used in this connection. Hence, where a corporation is projected for the purpose of acquiring a lease of certain land, a person who underwrites its shares is not discharged from the obligation to take them because the negotiation for the acquisition of that property falls through.⁵ So, an underwriter who underwrites a certain number of bonds is not discharged because the total number of bonds proposed to be issued is never underwritten.⁶

¹ *Electric Welding Co. v. Prince v. Grey*, 14 Times L. R. 373 (affirming 13 Times L. R. 564). (Mass.), 81 N. E. 306, 309 (semble)..

² *Electric Welding Co. v. Prince* Cf. *Paul Boyer, Ltd. v. Edwards*, (Mass.), 81 N. E. 306, 309 (semble). 17 Times L. R. 16.

³ *Electric Welding Co. v. Prince* 14 Times L. R. 47. ⁵ *Crown Lease Proprietary Co.*, (Mass.), 81 N. E. 306, 309.

⁶ *Knickerbocker Trust Co. v.*

⁴ *Sydney Harbour Collieries Co. Davis*, 143 Fed. 587.

§ 435. **Express condition that a certain Number of the Securities be Underwritten.** — Underwriting agreements usually fix a certain number of securities which must be underwritten before the several underwriters can be bound. Where this is the case, a third person who is party to the underwriting agreement and who thereby agrees to deliver stock as a bonus to the underwriters is not debarred from acting as underwriter by reason of the rule that no man can be both obligor and obligee; but, his agreement for delivery of the stock being regarded as severable, securities underwritten by that person may be counted in determining whether the required minimum has been underwritten so as to make the agreement binding on the other underwriters.¹

§ 436. **Discharge of Underwriter by Alteration of Risk.** — Inasmuch as an underwriting agreement is a contract of insurance, the underwriter will be discharged if without his consent any alteration is made in the risk. For example, if the amount of the securities to be offered to the public be changed, the underwriter's risk is altered, and he should be discharged. This is very clear where the amount of the securities offered to the public is increased. For the underwriter may have been willing to guarantee that the public would take a small number of shares or bonds, and yet be unwilling to guarantee that a larger number could be "floated." Where the number of the securities offered to the public is diminished, the case is not quite so clear, for it may be argued that the public is more likely to take all of a small than a large number of securities, so that the underwriter's risk is rather diminished than increased. Nevertheless, the underwriter should be discharged by the change. For he may have thought that if the company is launched as a great enterprise by an offer of a large number of the securities for public subscription, the public would be more likely to take them all than if a smaller number had been offered — a number so small as, perhaps, to attract no attention from financiers, or a number insufficient (in the judgment of some possible investors) to furnish the capital necessary to make the company a success. At all events, the diminution has produced a change in the under-

¹ *Eastern Tube Co. v. Harrison*, 140 Fed. 519 (headnote inadequate).

writer's risk without his consent, and as an insurer he should accordingly be discharged without pausing to inquire whether the change is prejudicial to him. Thus, where the underwriting agreement provides that each underwriter, who underwrites, say, fifty shares out of, say, a thousand to be offered to the public, shall only be called upon to take his proportion *pro rata* with the other underwriters, a reduction in the number of shares offered to the public will, it has been held, discharge the underwriter.¹ It was pointed out by the court that before the change the maximum proportion which each underwriter could possibly be called upon to take was five hundredths of the number of shares to be offered to the public, whereas if only five hundred shares should be offered to the public, each underwriter might be called upon to take as much as ten hundredths of the number offered for public subscription. In this particular case, the most substantial grievance was manifestly the change in the number of shares underwritten or in the number of underwriters rather than in the number of shares offered to the public. But as already stated, even if the only change had been in the number of shares offered to the public, it is submitted that the result should have been the same.

§ 437. **Right of Underwriter of Bonds to overdue Coupons.** — Where bonds are underwritten, it seems that the underwriter is entitled to any coupons which may mature after the execution of the underwriting agreement, but before he is called upon to take or pay for the bonds.²

§ 438-§ 441. *How far Underwriting Agreements are subject to the Special Rules applicable to Subscriptions to Securities of the Kind underwritten.*

§ 438. **In general.** — In so far as an underwriting agreement is a mere contract of subscription to shares or bonds, it is governed by the peculiar principles which are applicable to subscriptions to such securities and which are elsewhere considered. In other respects, underwriting agreements are in general subject to the ordinary principles of the law of contracts. This double aspect of underwriting agreements — as ordinary con-

¹ *Electric Welding Co. v. Prince* nor, 95 N. Y. App. Div. 6; 88 N. Y. (Mass.), 81 N. E. 306, 309. Supp. 742 (stated more fully infra,

² *Hudson Valley Ry. Co. v. O'Con-* § 1787).

tracts, and also as contracts of subscription — will not improbably lead to considerable difficulty when the matter comes before the courts. Take, for example, the question of how far an underwriter is entitled to repudiate his agreement on account of misrepresentations in the prospectus. If he be regarded simply as a subscriber to shares, he would in respect to this matter come under certain fairly well-established rules of law. If he be regarded as an ordinary contractor with the company, he would be subject to other and different rules. In point of fact, his position ought to be somewhat different from that of either.

§ 439. Underwriting Agreement binding although Conditional — Distinguished from other Conditional Subscriptions to Shares. — Conditional agreements to subscribe to bonds or debentures are obnoxious to no legal objection merely because they are conditional; and consequently, even if an underwriting agreement be regarded as, strictly, a contract of conditional subscription, a contract for the underwriting of bonds is valid. In the case of shares of capital stock, subscriptions upon a condition precedent are not in general binding until the condition is performed; but this rule is based upon the principle that the conditional subscriber ought not to have the right to prevent the company from allotting the shares to some one else while he himself may never be bound to take them. Hence, the rule has no application to underwriting agreements;¹ for although they be conditional subscriptions, yet the condition is of such a peculiar character that the company is at liberty to allot the shares to anybody it pleases while at the same time the underwriter is bound fast.

§ 440. Underwriter of Bonds not Discharged by Insolvency of Company. — A subscriber to bonds is ordinarily entitled to repudiate his subscription if the company becomes hopelessly insolvent before the money is paid and the bonds are issued; but although an underwriter of bonds or debentures is a conditional subscriber, yet his agreement is governed in this respect by different rules from an ordinary subscription to bonds.² The

¹ *Burke v. Smith*, 16 Wall. 390, 396–397 (where the subscription was in all its essential features an underwriting agreement although not called by that name). ² *Eastern Tube Co. v. Harrison*, 140 Fed. 519.

underwriter is paid for guaranteeing, as it were, the solvency of the company; and of course he cannot escape liability because the company turns out to be unsuccessful. Indeed, if the strict rules applicable to subscriptions to bonds were applied, the underwriter would not be liable for more than nominal damages even if the company is solvent.¹

§ 441. **Right of Underwriter to rescind underwriting Agreement for Fraud or Misrepresentation.** — If the underwriter signs the underwriting agreement in reliance upon a fraudulent prospectus, he is undoubtedly entitled to avoid the contract; although, as pointed out above, it may be doubted whether an underwriter of shares is necessarily subject to all the strict rules, requiring great diligence in discovering the fraud and repudiating the contract, that are applicable to ordinary subscribers to shares. This right of the underwriter to repudiate the agreement on the ground of fraud is not tolled because the underwriting agreement provides that it shall continue binding notwithstanding any variation between the proof prospectus as exhibited to the underwriter and the prospectus issued to the general public.²

It must be borne in mind that an underwriter is influenced by different considerations from those which would affect an investor, and that this fact may be material in determining whether the underwriter did rely upon misrepresentations in the prospectus. As was said by Farwell, J., in a recent English case, "The considerations which affect the careful man disposed to invest in an undertaking are very different from those that affect the underwriter, who, when he underwrote, thought that the public were going to take the thing up, and he would get his 20 per cent. without being liable to take any shares at all. . . . The investor wants a sound concern; the underwriter wants an attractive prospectus. I do not say that the underwriter supposes or desires that there should be any misstatement or concealment, but it is obvious that his interest is that the public be induced to subscribe." ³ A representation by one of the nominal underwriters that he is really risking his money by signing the agreement is very material, and any other person who signs the

¹ *Infra*, § 1720.

² *Baty v. Keswick*, 85 L. T., N. S.,

³ *Dadson's Case*, 12 Times L. R. 18, 20, per Farwell, J.
482.

agreement as an underwriter in reliance on that representation has good cause for complaint if the fact be that the first underwriter is really the substantial owner of all the securities underwritten, and has got up the underwriting plan for the purpose of "unloading " some of them.¹

It has been held that a person who is induced to become an underwriter by the fraudulent misrepresentations, not of the corporation but of a fellow-underwriter who being already largely interested in the securities to be underwritten had organized the underwriting scheme for his own benefit, may, on discovering the fraud, carry out his underwriting contract so far as the corporation is concerned, by accepting and paying for the securities underwritten, and may then maintain a suit against the fraudulent co-underwriter, without making the corporation a party, for a rescission of the agreement — that is to say, upon handing over to the co-underwriter the securities which he (plaintiff) had taken, he may recover from the co-underwriter the amount he had paid the company for them.² Nobody would doubt that in such a case the plaintiff might have an action of deceit against the co-underwriter to recover the difference between the price paid for the securities and their actual value; but the relief which was actually granted can only be sustained upon the theory that the corporation should be regarded as a mere alias for the co-underwriter, and even upon that theory it is difficult to understand why the acceptance of the securities after discovery of the fraud should not bar the right to rescission. The court seems to have regarded the corporation for some purposes as a mere alias for the fraudulent co-underwriter, but for other purposes as an independent entity — a not altogether consistent position.

• § 442-§ 445. ENFORCEMENT OF UNDERWRITER'S AGREEMENT.

§ 442. **Enforcement by Company directly.** — If the company be a party to the underwriting agreement, it may doubtless pursue the same remedies against the underwriter, in case he becomes bound to take any of the securities underwritten, as would have been available against an ordinary subscriber. In the case of underwriters of shares, these remedies are ample.

¹ *Rose v. Merchants' Trust Co.*,
96 N. Y. Supp. 946.

² *Rose v. Merchants' Trust Co.*,
96 N. Y. Supp. 946.

Thus, a binding underwriting agreement to which the company is a party entitles the company to put the underwriter's name upon its register of members in respect of any shares which by the terms of the agreement he may be bound to take.¹ The same thing is true where the underwriter's promise is "to underwrite or procure to be underwritten to the satisfaction of the directors": the original underwriter remains liable, in such a case, except in so far as approved substitutes may have been procured.² Where bonds are underwritten, the company's remedies are not so satisfactory; for it seems that equity will not specifically enforce a subscription to bonds or debentures against the subscriber,³ while at law only nominal damages can in general be recovered.⁴

§ 443-§ 445. *Enforcement by means of Power of Attorney to accept on behalf of Underwriter the Securities underwritten.*

§ 443. **Whether Power of Attorney is Revocable.** — We have seen above, that in England, for the purpose of enabling the company to enforce an underwriting agreement to which it is not a party, the expedient has been devised of taking from the underwriter a power of attorney whereby he constitutes and appoints the vendor or promoter his attorney to apply for and accept, on his behalf, the shares or bonds underwritten, in case the contingency arises in which by the terms of the agreement he is bound to take them. This power of attorney, being given for a valuable consideration, and the donee being interested in the flotation of the company, is deemed to be "coupled with an interest," and has been accordingly held to be irrevocable by the underwriter from the time of the underwriting agreement.⁵ To be sure, in a very recent Massachusetts case relating to an agreement to underwrite shares in an English company, Loring, J., said that the power of attorney "could be revoked by the underwriter, although to revoke it would expose the underwriter to

¹ *Ex parte Audain*, 42 Ch. D. 1.
See also *supra*, § 419.

² *Infra*, § 1720.

³ *Infra*, § 1720.

⁴ *London Paris Financial, etc. Corp.*, 13 Times L. R. 569, 570 (semble).

⁵ *Carmichael's Case* (1896), 2 Ch. 643. Cf. *Ex parte Stark* (1897), 1 Ch. 575, 586, 588.

Cf. *Globe Blocks Gold Mining Co.*, 12 Times L. R. 92.

action for damages for breach of contract,"¹ but this remark was unnecessary to the decision of the case before the court and ought not, it is submitted, even in Massachusetts, to be deemed binding authority in opposition to the English decisions. Indeed, if such a power of attorney is revocable, its efficacy is destroyed.

§ 444. **Conditions of Exercise of Power.**—The limits and conditions of the authority of the promoter as such agent or attorney for the underwriter must be strictly fulfilled. For example, if the underwriter agrees to subscribe for the shares underwritten if and when called upon to do so, and constitutes the promoter with whom the agreement is made his agent to apply in his name for any shares which he may thus be bound to take, he is not liable upon shares which are allotted in pursuance of an application made by the promoter unless he (the underwriter) was first called upon to subscribe.² So if the underwriter agrees to subscribe or find subscribers for certain shares before a certain date, and, in the event of his failure to comply with the terms of the agreement authorizes the promoter with whom it is made to apply for the shares as his agent, the promoter's authority does not arise unless the underwriter be first given an opportunity to subscribe and fails to avail of it.³ Where the underwriting agreement, contemplates that the underwriter will accompany it with a written application for the shares underwritten, and confers a power of attorney to apply for the shares in case that application is withdrawn, an English judge held that if no application for shares did in fact accompany the underwriting agreement and if none was in fact executed by the underwriter, such failure was equivalent to a withdrawal within the meaning of the underwriting agreement, and that the attorney was therefore authorized to apply for the shares in the under-

¹ *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306, 310.

² *Ormerod's Case* (1894), 2 Ch. 474; *Brussels Palace of Varieties v. Prockter*, 10 Times L. R. 72; *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306.

But cf. *Shaw v. Bentley & Co.*, 68 L. T. 812 (holding that where underwriter agrees to subscribe or

find subscribers for such of a number of shares as are not taken by the public, the attorney may apply for the shares without first notifying the underwriter of the number of shares he has become bound to take or find subscribers for).

³ *Ex parte Stark* (1897), 1 Ch. 575, 592, 601; *Bullfontein Sun Diamond Mines*, 13 Times L. R. 156.

writer's name.¹ If the underwriter authorizes the agent to "hand my application for shares to the company as my agent," the agent is not authorized to sign an application on the underwriter's behalf.² Moreover, if the underwriter agrees to subscribe or find subscribers for a certain number of shares and authorizes the agent to apply for "the said shares" on his behalf, the agent has no power to apply for any less number, although some of the shares may have been taken by the public.³

In general, the apparent authority of the agent does not exceed his actual authority, and hence the underwriter cannot be estopped from showing that the conditions upon which the agent's authority to act for him were to arise had not occurred, or from denying that any contract was ever consummated because although his offer to underwrite had apparently been accepted yet the acceptance had not been communicated to him in due time.⁴ If, however, the authority contained in the underwriting letter be subject to secret conditions in a separate paper which is not shown to the company, the underwriter will be estopped from setting up non-performance of the secret conditions if the company has allotted the shares in reliance upon the agent's ostensible authority as conferred by the underwriting letter.⁵

Moreover, if the attorney exceeds his authority ratification by the underwriter may sometimes be shown. When the underwriter receives notice that shares have been allotted to him upon the application of the attorney in excess of his authority, the underwriter must repudiate the shares promptly if he desire to escape liability:⁶ his position is not that of a person to whom shares have been allotted without any prior application on his part and who, as explained above,⁷ cannot be made a shareholder by mere inaction, but rather that of a principal whose agent has exceeded his authority and who, after learning of the excess of authority or after he might have learned of it by the

¹ *Globe Blocks Gold Mining Co.*, 575. Cf. *Gutta Percha Corp.*, 15 Times L. R. 92. Times L. R. 183.

² *Holophane v. Hesseltine*, 13 Times L. R. 7.

³ *Holophane v. Hesseltine*, 13 Times L. R. 7 (per Lord Esher, M. R.).

⁴ *Ex parte Stark* (1897), 1 Ch.

⁵ *Ex parte Harrison*, 69 L. T. 204 (explained in *Ex parte Stark* (1897), 1 Ch. 575).

⁶ *Electric Welding Co. v. Prince* (Mass.), 81 N. E. 306.

⁷ *Supra*, § 194.

exercise of due diligence, must take affirmative steps to repudiate his agent's action or be held to have tacitly ratified and acquiesced in it.

§ 445. **Advantages of taking a Power of Attorney from Underwriter.** — This expedient of taking from the underwriter an irrevocable power of attorney to apply for and accept on his behalf the securities which under his agreement he may become bound to take not merely enables the company to avoid any legal obstacles to the enforcement of the contract where the company itself is not a party, but also has additional advantage of being an automatic arrangement for securing specific performance of the underwriter's contract. In the case of underwriting of bonds, or debentures, this feature is particularly valuable; for, as explained below, equity will not specifically enforce a subscription to bonds or debentures against the subscriber, while at law only nominal damages can in general be obtained.¹ Accordingly, it is recommended that every agreement for the underwriting of bonds or debentures should contain or be accompanied by such a power of attorney.

§ 446. **Assignments of Underwriting Agreements.** — An underwriting agreement is a contract, and it would therefore seem that pecuniary rights arising under it may be assigned in the same way as other choses in action, although, to be sure, where shares are underwritten, an assignment by the corporation may not be effective unless an assignment of uncalled capital would be valid.² At any rate, where a company undertakes to assign an underwriting agreement to a bank as collateral security for a debt, and agrees to issue to the bank certificates for the requisite number of shares to be delivered to the underwriters, the assignment is so far effectual that if by inadvertence or otherwise the company fails to issue the certificates as agreed, the bank may require it to do so, the right of the bank to compel the underwriters to accept the certificates and make payment according to the underwriting agreement being left

¹ *Infra*, § 1720. Cf. *supra*, § 440 and § 442. ² See *supra*, § 72.

an open question.¹ Although an underwriting agreement is certainly not negotiable, yet where it expressly contemplates assignment as collateral security for loans to be made to the company, an underwriter cannot set off against a claim by the assignee a debt owing to the underwriter by the company:² any such defences the underwriter should be estopped to make.

¹ *Kirkpatrick v. Eastern Milling & Export Co.*, 137 Fed. 387; 69 C. C. A. 579. ² Cf. *Eastern Tube Co. v. Harrison*, 140 Fed. 519.

CHAPTER VIII

CORPORATE NAMES

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§ 447. **Necessity for a Corporate Name.** — The question has been mooted whether a special name is essential to corporate existence. Some authorities have said with Blackstone that when a corporation is erected, a name *must* be given to it, and that such a name is the very being of its constitution and the knot of its

combination.¹ Even these authorities admit that if no name is given in the charter, the corporation may assume an appropriate name, or acquire one by usage. Others have asserted, with much force, that stress should not be laid on the mere matter of name, but that the essential element in corporate existence is the *fact* of the union of several natural persons into an ideal or artificial legal personality, and not the designation of that fact by an appropriate name. But whatever be the correct theory, certain it is that in practice every corporation has and must have its individual corporate name.

§ 448-§ 450. *Choice of Corporate Name.*

§ 448. **How and by whom chosen.** — In case of corporations erected by royal charter, the corporate name was given by the king in the charter. In the case of corporations created by special act, the name is usually given by the legislature in the act of incorporation. On the other hand, when a corporation is formed under a general law, the incorporation paper must state the corporate name,² which is chosen by the promoters.

§ 449. **Statutory Restrictions upon Choice.** — Restrictions as to the choice of corporate names are often contained in general incorporation laws.³ The English Companies Act of 1862 makes the word "Limited" a necessary part of the corporate name of every company the liability of whose shareholders is limited;⁴ and similar provisions are sometimes found in the United States.⁵

¹ 1 Black. Comm., 475.

Cf. *Smith v. Tallahassee, etc. Plank Road Co.*, 30 Ala. 650, 664-665.

² *Supra*, § 117.

³ As to the discretionary power under the laws of some states to refuse a "charter" to an association whose name is colorless and not distinctive, see *Nether Providence Ass'n*, 12 Pa. Co. Ct. 666.

As to the discretionary power with respect to amendments, see *supra*, § 151.

⁴ Companies Act, 1862, § 14(2). See also *infra*, § 467.

⁵ Cf. *State ex rel. Mallinckrodt v. McGrath*, 75 Mo. 424 (statute mak-

ing the word "company" or "corporation" an essential part of the name of every corporation assuming the name of a person or firm held to apply where a family name not conjoined with a Christian name is used as part of the corporate title).

As to the construction of a statute requiring every corporation to print the word "incorporated" under its name on all "printed or advertising matter," see *Jung Brewing Co. v. Commonwealth* (Ky.), 96 S. W. 476; *Commonwealth v. American Snuff Co.* (Ky.), 101 S. W. 364 (holding that the use of the abbreviation "Inc." is not a compliance with the statute); *T. J. Moss Tie Co. v.*

Moreover, it is provided in England and in some of the American states that no company shall be incorporated or registered under a name identical with or so similar to that of a company previously formed as to be likely to deceive;¹ but as will presently be shown, all such provisions are merely declaratory of the common law,² except perhaps in so far as they authorize the registrar to refuse to receive or record an incorporation paper for a company whose name is misleading, instead of requiring him to register the instrument, leaving the parties aggrieved to redress by action at law or bill in equity.³ Provisions of this sort

Commonwealth (Ky.), 105 S. W. 163 (holding that a letter to the county attorney in reference to an assessment against the company is not "advertising matter").

The use of the abbreviation "Ltd." is not a compliance with a statute requiring the word "Limited" to be written or printed after the name of the company in all contracts; *Howell Lithographic Co. v. Brethour*, 30 Ont. R. 204. Where the statutes make the directors individually liable upon an instrument in which the name of the corporation is used without the word "limited" or the like, a drawer of a bill of exchange may hold the directors of the drawee individually liable upon the acceptance notwithstanding the fact that he himself omitted to use the word "limited": *Penrose v. Martyr*, E. B. & E. 499; *Howell Lithographic Co. v. Brethour*, 30 Ont. R. 204. But it is sufficient if the word appear in the body of the bill without being annexed to the acceptance: *Dermatine Co. v. Ashworth*, 21 Times L. R. 510. Cf. *Nassau Steam Press v. Tyler*, 70 L. T. 376 (where the directors were held liable because although they had used the word "limited," yet they had not given the correct corporate name in other respects); *Atkin & Co. v. Wardle*, 61 L. T. 23 (same point as last case); *Waterous Engine Works Co. v. McLean*, 2 Manitoba, 279 (where it was said

that the word "limited" although required by statute to be used was not in strictness part of the corporate name).

¹ Companies Act, 1862, § 20.

Cf. *Philadelphia Trust, etc. Co. v. Philadelphia Trust Co.*, 123 Fed. 534; *Dooley v. Cheshire Glass Co.*, 15 Gray 494, 496 (holding that a violation of such a requirement does not enable the company itself to plead that it is not incorporated); *Glucose Sugar Refining Co. v. American Glucose Sugar Refining Co.* (N. J.), 56 Atl. 861; *Young Women's Christian Ass'n v. St. Louis Women's Christian Ass'n*, 115 Mo. App. 228; 91 S. W. 171 (holding that the company whose corporate name is wrongfully appropriated has no right by virtue of the statute to appear and object to the grant of a certificate of incorporation to the new company).

² Cf. *British Vacuum Cleaner Co. v. New Vacuum Cleaner Co.* (1907), 2 Ch. 312.

But see *Aerators, Ltd. v. Tollitt* (1902), 2 Ch. 319, 322 (where it was said, *obiter*, that such a statute enables a company whose name is merely a common English word to prevent the registration of a company with a name absolutely identical).

³ It would seem, however, that the registrar may decline to receive any paper which adopts a misleading name even without any such express

do not apply to "re-incorporation" of existing organizations¹ nor to changes in the name of existing companies, but leave such cases to be governed by the common law both in respect to rights and remedies. Moreover, such a statutory provision does not vitiate the incorporation of a company which is formed with a name unduly similar to that of an existing corporation.²

§ 450. **Name must not be Fraudulent or Misleading.** — Even apart from any explicit statutory prohibition, the promoters of a corporation have no right to choose a name which involves a false statement or which is likely to mislead the public. A company incorporated under such a name is in one aspect not organized for a lawful purpose. The most common application of this principle is in cases where the corporate name is unduly similar to the trade name of some other person or corporation.³ But occasions for other applications of the same principle sometimes occur. For instance, the formation of a corporation under the name of "S. G. Rowell, Dentist, Limited," is likely to lead the public to conclude that either S. G. Rowell or the corporation is licensed to practise dentistry, and if that representation is false, the formation of the company under that name is illegal.⁴ Upon a similar principle, where an amendment is made to an incorporation paper whereby the old name becomes misleading, the courts sometimes insist on a change in the corporate name.⁵ Similarly, in a recent case, a federal judge decided that an association whose corporate name was the Franz Joseph Beneficial Association had adopted the name of the Austrian Emperor for the purpose of inducing Austrian immigrants to believe that the society was officially connected in some way with the Emperor Franz Joseph, and accordingly upon a bill filed by the Austrian consul enjoined the use of the Emperor's name or portrait.⁶

statutory authority. See *supra*, p. 125, note 3. Cf. *Rex v. Registrar Joint Stock Companies* (1904), 2 Ir. 634.

¹ *People ex rel. U. S. Grand Lodge v. Payn*, 161 N. Y. 229; 55 N. E. 849.

² *Dooley v. Cheshire Glass Co.*, 15 Gray (Mass.) 494.

³ *Infra* § 453-§ 455.

⁴ *Rex v. Registrar Joint Stock Companies* (1904), 2 Ir. 634; *Attorney-General v. Appleton* (1907), 1 Ir. 252.

Cf. *Attorney-General v. Myddletons* (1907), 1 Ir. 471.

⁵ Cf. *supra*, § 150.

⁶ *Von Thodorovich v. Franz Joseph Beneficial Ass'n*, 154 Fed. 911.

§ 451-§ 459. CONFLICTING CLAIMS OF RIGHT TO USE NAME
CHOSEN AS CORPORATE NAME.

§ 451. **Nature of Right to Use of Corporate Name — When not Exclusive.** — The mere fact of incorporation does not necessarily give the company any right, still less any exclusive right in the nature of a patent, to the use of the corporate name.¹ Thus, no monopoly or exclusive right can be acquired to the use of words of common import by inserting them in the corporate name² — for example, by inserting words descriptive of a particular kind of goods,³ or describing a particular kind of business,⁴ or indicating the previous unincorporated association from which the incorporators have seceded.⁵ The right to the use of a corporate name is not a franchise;⁶ and the

¹ *Imperial Mfg. Co. v. Schwartz*, 105 Ill. App. 525; *Blackwell's Durham Tobacco Co. v. Am. Tobacco Co.* (N. Car.), 59 S. E. 123. See also cases cited *infra*, § 454.

But cf. *Fort Pitt B. & L. Ass'n v. Model Plan B. & L. Ass'n*, 159 Pa. St. 308, 311; 28 Atl. 215.

² *Aerators, Ltd. v. Tollitt* (1902), 2 Ch. 319.

As to the use of geographical names, see *Elgin Nat. Watch Co. v. Loveland*, 132 Fed. 41; *Fort Pitt B. & L. Ass'n v. Model Plan B. & L. Ass'n*, 159 Pa. St. 308 (where at the suit of a corporation whose name included a geographical name, another corporation was enjoined from using the same name under void proceedings for a change of name); *Erie Printing Co. v. Erie Lithographing & Printing Co.*, 31 Pa. Co. Ct. 1.

³ *British Vacuum Cleaner Co. v. New Vacuum Cleaner Co.* (1907), 2 Ch. 312; *Goodyear India Rubber Glove Mfg. Co. v. Goodyear Rubber Co.*, 128 U. S. 598; 9 Sup. Ct. 166; *Plant Seed Co. v. Michel Plant & Seed Co.*, 37 Mo. App. 313 (where the word "Plant" in plaintiff's name was derived from the surname of its promoters, while in defendant's name it was a common noun).

Cf. *Glucose Sugar Refining Co. v.*

American Glucose Sugar Refining Co. (N. J.), 56 Atl. 861.

⁴ *Industrial Mutual Deposit Co. v. Central Mutual Deposit Co.*, 66 S. W. 1032; 112 Ky. 937; *Car Advertising Co. v. New York City Car Advertising Co.*, 107 N. Y. Supp. 547.

Cf. *International Committee Y. W. C. A. v. Y. W. C. A.*, 194 Ill. 194; 62 N. E. 551; 56 L. R. A. 888 (where an injunction was granted); *Colonial Dames of America v. Colonial Dames of New York*, 29 N. Y. Misc. 10; 60 N. Y. Supp. 302, affirmed short in 63 N. Y. App. Div. 615; 71 N. Y. Supp. 1134 (where an injunction was refused).

⁵ *Supreme Lodge Knights of Pythias v. Improved Order Knights of Pythias*, 113 Mich. 133; 71 N. W. 470; 38 L. R. A. 658; *Grand Lodge v. Graham*, 96 Iowa, 592; 65 N. W. 837; 31 L. R. A. 133; *La Tosca Club v. La Tosca Club*, 23 App. D. C. 96.

But see *Smith v. David H. Brand & Co.* (N. J.), 58 Atl. 1029; 67 N. J. Eq. 529 (where the defendant corporation had purchased the good will of a former partnership).

⁶ *Hazelton Boiler Co. v. Tripod Boiler Co.*, 137 Ill. 231; 28 N. E. 248.

But see *Boston Rubber Shoe Co.*

question is governed by the same principles as if the company were unincorporated.¹

§ 452. **When Right of Corporation is Exclusive.** — If, however, a corporation assumes some novel, fancy appellation to which others have no prior right, the fact of adoption of that title confers an exclusive right to its use.² So, where the name of a corporation includes the individual names of certain of its shareholders who subsequently sell their shares and form a new corporation under a title which likewise comprises their individual names, the right of the former company to the use of the name is superior to that of the latter.³ Similarly, a corporation may acquire by assignment from its promoters the right to the exclusive use of a trade name to which they were entitled, even as against a person who (without legal right) was using the same name at the time of the incorporation.⁴ The right of a corporation to the exclusive use of its corporate name is not forfeited because the company may be engaged in an illegal business.⁵

§ 453-§ 456. *Remedies against Improper Use of Names by or of Corporations.*

§ 453. **Injunction against Incorporation under Name to which Plaintiff has a prior Right.** — An unincorporated company may

v. Boston Rubber Co., 149 Mass. 436, 439; 21 N. E. 875.

¹ See *infra*, § 456.

As to the right of a corporation to enjoin an individual from adopting a name or addition tending to induce the belief that he is a member of the corporation, see *Society of Accountants and Auditors v. Goodway* (1907), 1 Ch. 489.

² *Illinois Watch Case Co. v. Pearson*, 140 Ill. 423; 31 N. E. 400; 16 L. R. A. 429; *Philadelphia Trust, etc. Co. v. Philadelphia Trust Co.*, 123 Fed. 534; *Koebel v. Landlords' Protective Bureau*, 210 Ill. 176; 71 N. E. 362; *Glucose Sugar Refining Co. v. American Sugar Refining Co.* (N. J.), 56 Atl. 861.

But see *Dodge Stationery Co. v. Dodge*, 145 Cal. 380; 78 Pac. 879 (where an injunction against the use of a similar corporate name to

plaintiffs was refused so far as defendant's business was different from plaintiffs'); *Legal Aid Society v. Co-operative Legal Aid Society*, 41 N. Y. Misc. 127; 83 N. Y. Supp. 926; *Blackwell's Durham Tobacco Co. v. Am. Tobacco Co.* (N. Car.), 59 S. E. 123 (declaring that the fact of incorporation under a certain name confers no exclusive right thereto unless followed up by the transaction of business under that name).

³ *Holmes, Booth & Haydens v. Holmes, Booth & Atwood Mfg. Co.*, 37 Conn. 278; 9 Am. Rep. 324. See also *infra*, § 458.

⁴ *Corbin v. E. Taussig & Co.*, 132 Fed. 662 (headnote inadequate).

⁵ *Grand Lodge v. Graham*, 96 Iowa 592; 65 N. W. 837; 31 L. R. A. 133.

enjoin the formation of a corporation under a name so similar to the complainant's as to be misleading,¹ and of course the same is true where the complaining company is itself incorporated.²

§ 454. **Injunction against Use of improper Corporate Name after Incorporation.** — If a company has been incorporated and received a certificate entitling it to do business under a deceptive name, the injured party may enjoin it from carrying on business thereunder,³ and may require the directors to have the name removed from the registry.⁴ But where the complaining company was organized only one month before the defendant and had done no business, whereas the defendant was in active operation, an injunction was refused.⁵ Where a corporate name is conferred by act of the legislature it would seem that its use

¹ *Hendricks v. Montagu*, 17 Ch. D. 638 (Universe Life Assurance Co., enjoined by Universal Life Assurance Co.); *Imperial Mfg. Co. v. Schwartz*, 105 Ill. App. 525 (where plaintiff, an individual, had been trading under the identical name afterwards adopted by the defendant corporation).

² *Tussaud v. Tussaud*, 44 Ch. D. 678 ("Louis Tussaud, L't'd," enjoined by Mme. Tussaud & Sons, L't'd); *Boston Rubber Shoe Co. v. Boston Rubber Co.*, 149 Mass. 436; 21 N. E. 875 (where plaintiff's name was given by a special act of incorporation).

But cf. *Elgin Nat. Watch Co. v. Loveland*, 132 Fed. 41, 52.

³ *Merchant Banking Co. of London v. Merchants Joint-Stock Bank*, 9 Ch. D. 560; *Manchester Brewery Co. v. North Cheshire and Manchester Brewery Co.* (1898), 1 Ch. 539 (where the name of the defendant company was held to suggest deceitfully an amalgamation between the plaintiff and some other concern); *Holmes, Booth & Haydens v. Holmes, Booth & Atwood Mfg. Co.*, 37 Conn. 278; 9 Am. Rep. 324; *Newby v. Oregon Central Ry. Co.*, Deady 609; *Celluloid Mfg. Co. v. Cellonite Mfg. Co.*, 32 Fed. 94; *Armington v. Palmer*,

21 R. I. 109; 42 Atl. 308; 79 Am. St. Rep. 786; 43 L. R. A. 95 (where complainant was an individual); *People ex rel. Columbia Chemical Co. v. O'Brien*, 101 N. Y. App. Div. 296; 91 N. Y. Supp. 649 (semble); *Nesne v. Sundet*, 101 N. W. Rep. 490; 93 Minn. 299 (where complainants were co-partners); *American Novelty Mfg. Co. v. Manufacturing Electrical Novelty Co.*, 36 N. Y. Misc. 450; 73 N. Y. Supp. 755; *Eureka Fire Hose Co. v. Eureka Rubber Mfg. Co.* (N. J.), 60 Atl. 561 (where the injunction was limited to using the name in dealing in the same class of goods as the plaintiff).

Cf. *American Clay Mfg. Co. v. American Clay Mfg. Co.*, 198 Pa. St. 189; 47 Atl. 936.

⁴ *Société Anonyme des Anciens Établissements Panhard et Levassor v. Panhard Levassor Motor Co.* (1901), 2 Ch. 513.

As to whether the corporation is a necessary party to a suit for an injunction against its officers, see *Elgin Nat. Watch Co. v. Loveland*, 132 Fed. 41, 46 (headnote inadequate).

⁵ *Hygeia Water Ice Co. v. New York Hygeia Ice Co.*, 140 N. Y. 94; 35 N. E. 417.

cannot be enjoined on the ground that it is misleading and unduly similar to that of some existing company.¹

§ 455. **Power of Courts to forestall or overrule Discretion of Public Officer Charged with Duty of passing on Propriety of Corporate Name.** — In a Massachusetts case, it was held that a statute which authorizes some public official to refuse a certificate of incorporation if the name of the proposed company is so similar to a name already in use as to be misleading and provides that the certificate if granted shall be conclusive evidence of the existence of the corporation, confides the whole matter of undue similarity of names to the public officer's discretion, so as to prevent any bill in equity or writ of mandamus to overrule or forestall his conclusion,² but this decision is directly contrary to the English cases³ as well as to the trend of American authority,⁴ and ought not, it is submitted, to be followed. The courts will not coerce a registrar by mandamus to record an incorporation paper where the name of the proposed company is so similar to that of an existing company that an injunction would be granted against its use.⁵

§ 456. **Receipt of Mail intended for another Company.** — Questions as to conflicting rights to the use of a corporate name are usually determined upon injunction proceedings by one company to restrain the other from the use of its name. In a recent case the question arose with reference to the mutual rights of the two corporations with respect to mail addressed in such a way as to be ambiguous. In such a case, the company which is respon-

¹ *Paulino v. Portuguese Beneficial Ass'n*, 18 R. I. 165; 26 Atl. 36; 20 L. R. A. 272.

But see *Edison Storage Battery Co. v. Edison Automobile Co.*, 56 Atl. 861, 866; 67 N. J. Eq. 44 (semble).

² *American Order S. C. v. Merrill*, 151 Mass. 558; 24 N. E. 918; 8 L. R. A. 320.

³ *Tussaud v. Tussaud*, 44 Ch. D. 678.

⁴ Cf. *Grand Lodge v. Graham*, 96 Iowa 592; 65 N. W. 837; 31 L. R. A. 133; *Ex parte Walker*, 1 Tenn. Ch. 97, 100, 101; *State ex rel. Hutchinson v. McGrath*, 92 Mo. 355; 5 S. W. 29 (holding that the officer will not

be required by mandamus to grant the certificate except in a clear case); *People ex rel. Columbia Chemical Co.*

v. O'Brien, 101 N. Y. App. Div. 296; 91 N. Y. Supp. 649 (holding that where officer registers the incorporation, certiorari will not lie to revoke his determination, the only remedy being in equity, but semble, if he erroneously refuses registration, certiorari might lie to compel him to do so); *Knights of Maccabees v. Searle* (Nebr.), 106 N. W. 448 (officer enjoined from issuing a certificate).

⁵ *People v. Rose*, 219 Ill. 46; 76 N. E. 42; *People ex rel. Felter v. Rose*, 80 N. E. 293; 225 Ill. 496.

sible for the confusion should bear the inconvenience of having its mail opened by the other corporation. Thus, where one corporation was named the Central Trust Company of Illinois and the other the Central Trust Company, both being engaged in business in Chicago, but the latter having obtained the right to do business in Illinois after the incorporation of the former, the court held that letters addressed to the "Central Trust Company, Chicago," without mentioning street or number, should be delivered to the Central Trust Company of Illinois.¹

§ 457. **How to determine whether Corporate Names are unduly similar to one another.** — Whether two corporate names are so similar as to be deemed misleading is to be decided according to the general principles of law applicable to trade names and not by any peculiar rule of corporation law.² It has been held that "the International Loan & Trust Co. of Kansas City" is not unreasonably similar to "The International Trust Co.," stress being laid on the addition of the words "of Kansas City";³ but by other courts a very similar distinction has been thought to be insufficient.⁴ "The Columbian Chemical Co." too nearly resembles "The Columbia Chemical Co."⁵ "Aerators, Limited," cannot enjoin the registration of "Automatic Aerators Patents, Limited,"⁶ nor the "British Vacuum Cleaner Co." the "New Vacuum Cleaner Co."⁷; for in such cases the title consists of

¹ *Central Trust Co. v. Central Trust Co. of Illinois*, 149 Fed. 789. Mass. 271; 26 N. E. 693; 10 L. R. A. 758.

Cf. *Erie Printing Co. v. Erie Lithographing & Printing Co.*, 31 Pa. Co. Ct. 1, 5 (where the court held that the two names were not unreasonably similar, but in view of the fact that confusion arose through the carelessness of correspondents, suggested the appointment of a receiver to open the mail).

Cf. *Farmers' Loan & Trust Co. v. Farmers' Loan & Trust Co. of Kansas*, 1 N. Y. Supp. 44.
⁴ *Saunders v. Sun Life Assurance Co. of Canada* (1894), 1 Ch. 537; *Central Trust Co. v. Central Trust Co. of Illinois*, 149 Fed. 789, 990 (semble); *Bradley Fertilizer Co.*, 19 Pa. Co. Ct. 271.

⁵ *People ex rel. Columbia Chemical Co. v. O'Brien*, 101 N. Y. App. Div. 296; 91 N. Y. Supp. 649.
⁶ *Aerators, Ltd., v. Tollitt* (1902), 2 Ch. 319.

⁷ *British Vacuum Cleaner Co. v. New Vacuum Cleaner Co.* (1907), 2 Ch. 312.

³ *International Trust Co. v. International Loan & Trust Co.*, 153

mere descriptive words.¹ The character of the business and the location of the two companies must be considered.² The fact, however, that the defendant company does not intend to carry on the same business as the complainant has been held to be immaterial if it has corporate power so to do.³ The act of the complaining corporation in organizing subsidiary corporations each of which includes in its corporate name the words of which a monopoly is claimed may, it seems, be taken as an admission that those words are merely descriptive of the character of goods sold by the complainant and that the use of those words by other corporations will not necessarily lead to confusion.⁴ But, on the other hand, the fact that a corporation has suffered one company to infringe its right to exclusive use of its corporate name will not prevent it from enjoining another subsequently organized company from so doing.⁵ It seems that there is no objection to the assumption by a new corporation of a name similar to or even identical with the name of a former corporation which has been absorbed by another organization bearing a very different name.⁶

§ 458. **Transfer to Corporation of a Promoter's Right to carry on Business under his own Name.** — Although an individual is entitled *bona fide* to carry on business under his own name even though it resemble that of some established concern, yet this is a personal right which he cannot confer upon any third person, and consequently not even upon a corporation organized by him, since the latter is a distinct legal entity.⁷ In a very recent English

New Vacuum Cleaner Co. (1907), 2 Ch. 312.

¹ See *supra*, § 451.

² *State ex rel. Hutchinson v. McGrath*, 92 Mo. 355, 358; 5 S. W. 29; *Dodge Stationery Co. v. Dodge*, 145 Cal. 380; 78 Pac. 879; *Dunlop Pneumatic Tyre Co. v. Dunlop Motor Co.* (1907), A. C. 430, 438 ("The objects of the two companies need not be absolutely identical in order to entitle the complainants to relief, but there must be great similarity").

³ *Edison Storage Battery Co. v. Edison Automobile Co.*, 56 Atl. 861; 67 N. J. Eq. 44.

But cf. *Aerators, Ltd. v. Tollitt* (1902), 2 Ch. 319.

⁴ *British Vacuum Cleaner Co. v. New Vacuum Cleaner Co.* (1907), 2 Ch. 312, 330.

⁵ *Atlas Assurance Co. v. Atlas Insurance Co.* (Iowa), 112 N. W. 232.

⁶ *Re Duquesne College Charter*, 12 Pa. Co. Ct. Rep. 491.

⁷ *Fine Cotton Spinners, etc. Ass'n v. Harwood Cash & Co.* (1907), 2 Ch. 184, 189, 190; *Tussaud v. Tussaud*, 44 Ch. D. 678; *Charles S. Higgins Co. v. Higgins Soap Co.*, 144 N. Y. 462; 39 N. E. 490; 43 Am. St. Rep. 769; 27 L. R. A. 42; *R. W. Rogers Co. v. Wm. Rogers Mfg. Co.*, 70 Fed. Rep. 1017; 17 C. C. A. 576 (upon the ground of actual fraud in assuming the name); *Dodge Station-*

case, the suggestion was thrown out that possibly a distinction might exist if the individual before attempting to assign his personal right to a corporation first builds up a business in his own name and then transfers the good will and name to a corporation.¹

§ 459. **Conflicting Rights of Domestic and Foreign Corporations.**—Where a dispute arises between a foreign company and a domestic company respecting the right to the use of a trade name, very difficult questions, which perhaps are not in strictness within the scope of this treatise, may be raised. In some of the United States, statutes expressly provide that no foreign corporation shall be allowed to do business within the state under a name so similar to that of a domestic company as to be likely to mislead.² Under such a statute it may be immaterial whether the foreign or the domestic company was first incorporated, or whether the one or the other had first transacted business within the state. But apart from such provisions, the maxim, *qui prior est tempore potior est jure*, would seem to apply. Thus, a foreign corporation cannot enjoin a domestic company from using a corporate name similar to that of the complainant but adopted before the latter's organization,³ unless the foreign company

ery Co. v. Dodge, 145 Cal. 380; 78 Pac. 879; *McFell Electric & Telephone Co. v. McFell Electric Co.*, 110 Ill. App. 182 (proceeding in part upon the ground that the individual in question had conferred upon the complainant company the right to use his name).

Cf. *Edison Storage Battery Co. v. Edison Automobile Co.* (N. J.), 56 Atl. 861; 67 N. J. Eq. 44; *International Silver Co. v. Wm. G. Rogers Co.*, 113 Fed. 526; *Hall's Safe Co. v. Herring-Hall-Marvin Safe Co.*, 146 Fed. 37; 76 C. C. A. 495, affirmed with modifications, 208 U. S. 554; *Bagby & Rivers Co. v. Rivers*, 87 Md. 400; 40 Atl. 171; 67 Am. St. Rep. 357; 40 L. R. A. 632; *International Silver Co. v. Simeon, etc. Rogers Co.*, 110 Fed. 955; *Peck Bros. & Co. v. Peck Bros. Co.*, 113 Fed. 291; 51 C. C. A. 251; *Dunlop Pneumatic Tyre Co. v. Dunlop Motor Co.* (1907), A. C. 430.

But see contra, *Howe Scale Co.*

v. Wyckoff, Seamans & Benedict, 198 U. S. 118 (headnote inadequate); 25 Sup. Ct. 609; *Donnell v. Herring-Hall-Marvin Co.*, 208 U. S. 267.

¹ *Fine Cotton Spinners, etc. Ass'n v. Harwood Cash & Co.* (1907), 2 Ch. 184. Cf. *Dunlop Pneumatic Tyre Co. v. Dunlop Motor Co.* (1907), A. C. 430.

² *International Trust Co. v. International Loan & Trust Co.*, 153 Mass. 271; 26 N. E. 693; 10 L. R. A. 758 (holding that the material point is not the corporate name of the foreign company but the name under which its business is transacted).

³ *Hazelton Boiler Co. v. Hazelton Tripod Boiler Co.*, 142 Ill. 494; 30 N. E. 339 (criticised in *Peck Bros. & Co. v. Peck Bros. Co.*, 113 Fed. 291; 51 C. C. A. 251).

succeeds by assignment to the right of a company which had been previously incorporated.¹ In England, it was held that a British company which had done business for more than eighty years under the name of the Sun Life Assurance Society could not enjoin a foreign company, called the Sun Life Assurance Company of Canada, from transacting business in Great Britain under its corporate name, although it was conceded to resemble the plaintiff's so closely as to be likely to cause confusion; but it was also held that the Canadian company should be strictly confined to its corporate name, and should be enjoined from abbreviating the same by omission of the words "of Canada" or otherwise.² This decision is extremely liberal to the foreign corporation, and, indeed, in view of the priority of organization of the domestic company would seem to be more liberal than sound principle justifies; and accordingly in America in such a case the prior right of the domestic corporation would probably be recognized.³ The mere existence of a foreign company which had never transacted business within the state and whose wares or manufactures were not habitually imported for sale, would seem to furnish no reason against the adoption of a similar name by a domestic corporation. But although the foreign company may never have had an office or agency within the state, yet if its goods are in fact frequently imported it may enjoin a domestic corporation from using a corporate name which is unreasonably similar to the plaintiff's name and which has been adopted for the fraudulent purpose of getting the benefit of the plaintiff's reputation.⁴ *A fortiori*, a foreign company which has lawfully transacted business within the state may enjoin a domestic company from adopting a name unfairly similar to its own, with the same effect as if the com-

¹ *Peck Bros. & Co. v. Peck Bros. Co.*, 113 Fed. 291; 51 C. C. A. 251. with the foreign corporation had severed the connection on grounds

² *Saunders v. Sun Life Assurance Co. of Canada* (1894), 1 Ch. 537.

³ *American Clay Mfg. Co. v. American Clay Mfg. Co.*, 198 Pa. St. 189; 47 Atl. 936.

Cf. *State Council, etc. v. National Council, etc.* (N. J.), 64 Atl. 561 (where the domestic corporation after several years of affiliation

which were held sufficient).

⁴ *Société Anonyme des Anciens Établissements Panhard et Levassor v. Panhard Levassor Motor Co.* (1901), 2 Ch. 513 (where the complaining company was unincorporated).

Cf. *Pinet et Cie. v. Maison Louis Pinet* (1898), 1 Ch. 179.

plainant had been a domestic corporation;¹ and conversely in such a case the domestic company would have no remedy against the foreign company.² A domestic corporation, formed while a foreign corporation with an almost identical name is transacting business within the state in violation of its laws as to the transaction of business by foreign corporations, has been held to have a better right than the foreign company to the use of the corporate name.³

Where the statutes of a state require an officer to issue a license to do business within the state to all foreign corporations which comply with certain statutory formalities, it has been held that the officer cannot refuse a license on the ground that the applicant's name is unreasonably similar to that of some domestic company;⁴ but on the other hand even if the license be granted, the domestic company may enjoin the foreign company from using the misleading name within that state.⁵

§ 460-§ 461. *Misnomer of Corporations.*

§ 460. **In general.** — Misnomer in the case of a corporation is attended by precisely the same consequences as in the case of an individual. Thus, a corporation is bound by its contracts, whether under seal or not, even though entered into under an erroneous name;⁶ and conversely, a corporation is entitled to

¹ *Philadelphia Trust, etc. Co. v. Co. v. Van Cleave*, 183 Ill. 330; *Philadelphia Trust Co.*, 123 Fed. 55 N. E. 698; 47 L. R. A. 795.

534; *Knights of Maccabees v. Searle* (Nebr.), 106 N. W. 448; *Atlas Assurance Co. v. Atlas Insurance Co.* (Iowa), 112 N. W. 232; *Bradley Fertilizer Co.*, 19 Pa. Co. Ct. 271. ⁵ *American Clay Mfg. Co. v. American Clay Mfg. Co.*, 198 Pa. St. 189; 47 Atl. 936.

⁶ *Clement v. City of Lathrop*, 18 Fed. 885; *Midland Steel Co. v*

But see *Lehigh Valley Coal Co. v. Hamblen*, 23 Fed. 225; *People ex rel. Home Life Insurance Co. v. Home Life Assurance Co.*, 111 Mich. 405; 69 N. W. 653. *Citizens' Nat. Bank*, 72 N. E. 290; 34 Ind. App. 107 (where the corporation used the name of its president as a business name).

But see *Hambro v. Hull, etc. Fire Ins. Co.*, 3 H. & N. 789.

² *Ottoman Cahvey Co. v. Dane*, 95 Ill. 203; *Blackwell's Durham Tobacco Co. v. Am. Tobacco Co.* (N. Car.), 59 S. E. 123. Cf. *Robinson v. First Nat. Bank* (Tex.), 82 S. W. 505 (where the members of a corporation, having begun to trade under a new name, were sued as partners).

³ *Central Trust Co. v. Central Trust Co. of Illinois*, 149 Fed. 789.

⁴ *People ex rel. Traders' Fire Ins.*

enforce its contracts notwithstanding any such error.¹ So, a corporation may have the benefit of a legacy or devise made to it by an erroneous name.² Similarly, misnomer in an appointment of a corporation as executor is immaterial.³ So, misnomer of a corporation in a statute is immaterial.⁴ All that is necessary in any of these cases is that the corporation in question be in fact the company intended to be designated. In order to show that there is a mere case of misnomer and not two distinct corporations, the identity of the company must appear.⁵ Where the similarity of name is very close, this may be presumed; but such a presumption, unless supported by affirmative proof,⁶ is very unreliable. For instance, it has been held that a deed to the "Odd Fellows Building and Savings Company" will not convey title to a corporation whose corporate name is the "Odd Fellows Building and Exchange Company," where there is no sufficient extraneous proof that the difference of name is a mere misnomer.⁷

§ 461. **Misnomer in Pleadings.** — Upon the same principle that misnomer in the case of a corporation is attended with the same consequences as in the case of an individual, it follows

¹ *Hagerstown Turnpike Road Co. v. Creeger*, 5 H. & J. 122; 9 Am. Dec. 495; *Medway Cotton Manufactory v. Adams*, 10 Mass. 360; *Commercial Bank v. French*, 21 Pick. (Mass.) 486, 490; *Berks & Dauphin Turnpike Road v. Myers*, 6 Serg. & R. (Pa.) 12.

² *Woman's Foreign Missionary Soc. v. Mitchell*, 93 Md. 199; 48 Atl. 737; 53 L. R. A. 711; *Reilly v. Union Protestant Infirmary*, 87 Md. 664; 40 Atl. 894; *Jordan v. Richmond Home for Ladies* (Va.), 56 S. E. 730; *Doan v. Vestry of Parish of Ascension* (Md.), 64 Atl. 314; *Peckham v. Newton*, 15 R. I. 321; 4 Atl. 758.

³ *Re Maher*, 18 Vict. L. R. 519 (where parolevidence of the testator's directions to the solicitor who drew the will was admitted to show that by an appointment of "The Trustees Executors and Agency Company, Melbourne," the testator intended "The National Trustees Executors

and Agency Company of Australia, Limited," rather than "The Trustees Executors and Agency Company, Limited").

⁴ *Attorney-General v. Chicago, etc. Ry. Co.*, 35 Wisc. 425, 556-558.

⁵ *Langhorne v. Richmond City Ry. Co.*, 91 Va. 364; 22 S. E. 357; *Smith v. Tallahassee, etc. Plank Road Co.*, 30 Ala. 650.

Cf. *Robinson v. First Nat. Bank*, 82 S. W. 505 (Tex.); *McCord-Collins Co. v. Prichard*, 84 S. W. 388 (Tex.); *Brassfield v. Quincy, etc. R. R. Co.*, 109 Mo. App. 710; 83 S. W. 1032 (where the alleged error consisted in omitting the word "Company" from the defendant's name); *Riemann v. Tyroler, etc. Verein*, 104 Ill. App. 413.

⁶ As to the use of parol evidence, see *Jordan v. Richmond Home for Ladies* (Va.), 56 S. E. 730.

⁷ *Cobb v. Bryan* (Tex.), 83 S. W. 887.

that in an action at law under the common law system of pleading, misnomer of either the plaintiff or defendant must be pleaded in abatement and cannot be availed of under the general issue or other plea in bar, or even under a plea of *nul tiel corporation*.¹ So, in equity, misnomer of a corporation, whether plaintiff or defendant, must be pleaded in abatement and cannot be taken advantage of by answer.² If, however, the objection be raised by a proper form of pleading a very slight misnomer may be fatal, as in the case of an individual. For instance, the use of the word "the" before the title of the defendant corporation, when the corporate name contains no definite article, has been held to be a fatal misnomer.³ If an act of incorporation (and

¹ *Baltimore, etc. R. R. Co. v. Fifth Baptist Church*, 137 U. S. 568; 11 Sup. Ct. 185; *Gilbert v. Nantucket Bank*, 5 Mass. 97 (arising on motion in arrest of judgment); *Wilhite v. Convent of Good Shepherd*, 78 S. W. 138; 25 Ky. L. Rep. 1375 (motion to quash summons, which, however, did not "give plaintiff a better writ"); *Riemann v. Tyroler, etc. Verein*, 104 Ill. App. 413; *Associate Presbyterian Congregation v. Hanna*, 113 N. Y. App. Div. 12; 98 N. Y. Supp. 1082 (denial of incorporation not sufficient to raise the defence under N. Y. Code); *Gray v. Monongahela Nav. Co.*, 2 Watts & S. 156; 37 Am. Dec. 500; *President, etc. of Hanover Savings Fund v. Suter*, 1 Md. 502 (plea of non-assumpsit).

Cf. *Smith v. Tallahassee, etc. Plank Road Co.*, 30 Ala. 650 (where an amendment was allowed); *Bank of Utica v. Smalley*, 2 Cow. (N. Y.) 770; 14 Am. Dec. 526 (where the point was left open); *Washington County Nat. Bank v. Lee*, 112 Mass. 521; *University of Louisville v. Hammock* (Ky.), 106 S. W. 219 (objection not available for the first time on appeal).

But see *Illinois State Hospital v. Higgins*, 15 Ill. 185 (where misnomer of the plaintiff corporation was held a ground for demurrer); *Southern Pac. Co. v. Block*, 84 Tex. 21; 19 S. W. 300 (a judgment against

"The Southern Pac. Co." held unauthorized where the writ ran against "The Southern Pacific Railway Co."); *Town of East Rome v. City of Rome* (Ga.), 58 S. E. 854 (where an action brought in the name of the "Town of E. R.," whereas the corporate name was the "Mayor and City Council of the town of E. R.," was held to be a mere nullity).

In *Glass v. Tipton, etc. Co.*, 32 Ind. 376, condemnation proceedings taken in a name varying somewhat from the true corporate name were held invalid.

As to mechanics' lien proceedings, see *Grafton Grocery Co. v. Home Brewing Co.* (W. Va.), 54 S. E. 349.

² *Young v. South Tradegar Iron Co.*, 85 Tenn. 189; 2 S. W. 202; 4 Am. St. Rep. 752.

³ *Lapham v. Philadelphia, etc. R. R. Co.* (Del.), 56 Atl. 366; 4 Pennell's (Del.) Rep. 421.

Contra: *Western, etc. Trust Co. v. Ogden* (Tex.), 93 S. W. 1102.

Cf. *Texas, etc. R. R. Co. v. Barber* (Tex.), 71 S. W. 393; 31 Tex. Civ. App. 84 (where the words "of 1874" after the company's name in a petition were said to be mere surplusage).

As to the use of a new name before a change has been completely effected, and use of old name after the change, see *infra*, § 466, § 467.

the same statement might doubtless be made with respect to an incorporation paper under modern general laws), refers to the company by an abbreviated form of the corporate name, the use of such abbreviated form is thereby sanctioned, and will therefore not be deemed a misnomer.¹

In order that the use in pleadings of an erroneous name may have no consequences more serious than those attaching to misnomer, the erroneous designation must have been actually intended to refer to the company in question and not to another corporation. There is sometimes a presumption to this effect. So, a company described in a pleading as the Campbell and Zell Company will be presumed to be identical with a company whose corporate name is the Campbell and Zell Company of Baltimore City.² Where a suit is brought against an individual who is supposed to be carrying on business under a company name, the plaintiff upon learning that the company was in fact incorporated cannot treat the case as a mere misnomer of the defendant so as to make the corporation by its corporate name the defendant.³ In an early Maryland case, where a bill was filed against the president and the directors of a company whose corporate name was The Chesapeake and Ohio Canal Company, the real complaint being against the corporation, the chancellor expressed the opinion that the corporation by appearing in the suit might have treated the defect as a mere misnomer.⁴

§ 462-§ 465. *Inferences from Corporate Name.*

§ 462. **In construing Incorporation Paper.**—The corporate name may be material in construing an incorporation paper and in determining the company's objects and powers.⁵ Thus, powers to engage in land speculation, a promoting business, or in stock-jobbing, will not be conferred by mere general words where the

¹ Cf. *Merrick v. Trustees, etc. of Bank of the Metropolis*, 8 Gill (Md.) 631.

59, 67-68 (headnote inadequate). But see *Town of East Rome v. City of Rome* (Ga.), 58 S. E. 854 (stated *supra*, p. 107, note 5).

² *Campbell & Zell Co. v. American Surety Co.*, 129 Fed. 491.

³ *Licausi v. Ashworth*, 78 N. Y. v. *Marsh*, 7 Fed. Cas. 939.

name of the company is "The Crown Bank."¹ Of course, however, the name is not conclusive;² and therefore if the objects of the company as expressed in its incorporation paper clearly show that it is not the kind of corporation its name would indicate, the courts will hold that the company may enjoy the powers and should be subject to the duties annexed by the law to the class of corporations to which it really belongs rather than to the class which its name would indicate.³

§ 463. **Corporate Name as brief Description of Company's Business.** — So, the corporate name may be treated for other purposes as to some extent a description of the company and its business. For instance, under an English statute which requires a bill of sale to be accompanied by an affidavit containing a description of the grantor's occupation, a mere statement of the company's name — "The Glucose Sugar and Colouring Company" — may be a sufficient compliance with the act.⁴

§ 464. **Corporate Name as Allegation that Company is incorporated.** — Similarly, a statement of a name which is usually applicable to a corporation may, in pleading, be equivalent to an averment or admission that the company is incorporated.⁵ So,

¹ *Crown Bank*, 44 Ch. D. 634.

So, in determining a company's "main purpose," regard may be had to the corporate name: *Governments Stock Investment Co.* (1891), 1 Ch. 649.

² *Hamilton Nat. Bank v. American Loan, etc. Co.*, 92 N. W. 189, 192 (headnote inadequate); 66 Nebr. 67.

³ *Minneapolis, etc. Suburban Ry. Co.* (Minn.) 112 N. W. 13.

⁴ *Shears v. Jacob*, L. R. 1 C. P. 513.

Cf. *Dyer v. Drucker*, 108 N. Y. App. Div. 238; 95 N. Y. Supp. 749 (the name "City and Resort Hotel Co." held insufficient to show that company was a "stock corporation" and not a "monied corporation").

⁵ *Adams Express Co. v. Harris*, 120 Ind. 73; 21 N. E. 340; 16 Am. St. Rep. 315; 7 L. R. A. 214 ("Adams Express Co."); *Norton v. State*, 74 Ind. 337 ("Terre Haute & Evansville Railroad Co."); *Ft. Wayne Gas Co. v. Nieman* (Ind.),

71 N. E. 59; 33 Ind. App. 178 ("Ft. Wayne Gas Co."); *Perkins Co. v. Sheumake*, 119 Ga. 617; 46 S. E. 832 ("C. H. Perkins Co."); *Mattox v. State*, 115 Ga. 212, 219; 41 S. E. 709 ("Acme Brewing Co."); *Georgia Co-op., etc. Ass'n v. Borchardt*, 123 Ga. 181; 51 S. E. 429 ("Georgia Co-operative Fire Association"); *U. S. Express Co. v. Bedbury*, 34 Ill. 459 ("U. S. Express Co."); *Stein v. Indianapolis, etc. Ass'n*, 18 Ind. 237 ("Indianapolis Bldg. Loan Fund and Savings Ass'n"); *Harris v. Muskingum Mfg. Co.*, 4 Blackf. (Ind.) 267; 29 Am. Dec. 372 ("Muskingum Mfg. Co.").

Cf. *Holcomb v. Cable Co.*, 119 Ga. 466; 46 S. E. 671 ("Cable Co."); *Snyder v. Philadelphia Co.*, 54 W. Va. 149; 46 S. E. 366; 102 Am. St. Rep. 941; 63 L. R. A. 896; *Whitt v. Blount*, 124 Ga. 671; 53 S. E. 205 (held, that "Artope & Whitt Co." "prima facie imports a corporation," but that this presumption is over-

it has been said that the use of a name such as is usually adopted by corporations, and not containing the name of any individual as is customary in the case of simple partnerships, indicates, *prima facie* at least, corporate existence.¹ So, a reference in a deed to an organization by the name of the "Anglo-Californian Bank" has been held to import an admission by the parties to the deed that the bank is incorporated.² But such inferences are uncertain³ and ought not, it is submitted, to be indulged.⁴ Thus, a warranty that certain property is owned by the N. S. Company does not amount to a warranty that the property is owned by a corporation, but is fully satisfied if the owner is an individual or a firm trading under that name.⁵

§ 465. **Use of Name without word "limited" and as Notice that Liability of Shareholders is unlimited.** — Moreover, where statutes require the word "limited," or some similar word, to be appended to the name of all companies the liability of whose shareholders is limited, the absence of the word from the name used by a company may charge an applicant for shares with notice that the company is in fact unlimited. Thus, where a person applied for shares in a company, the form of application giving the

thrown where plea refers to the business as owned by the defendants); *Van Winkle Gin, etc. Co. v. Mathews* (Ga.), 58 S. E. 396.

As to the use of corporate names as evidence of incorporation, see *supra*, § 274.

¹ *Jones v. Cincinnati Type Foundry Co.*, 14 Ind. 89 ("Cincinnati Type Foundry Co.").

Cf. *Williamsburg, etc. Ins. Co. v. Frothingham*, 122 Mass. 391 (where the word *successors* was used in connection with a company's name); *Platte Valley Bank*, 1 Nebr. 461 ("Platte Valley Bank"); *Sierra Land, etc. Co. v. Bricker* (Cal.), 85 Pac. 665.

As to statutes forbidding the use by individuals of names purporting to be corporate names, see *Imperial Mfg. Co. v. Schwartz*, 105 Ill. App. 525.

² *Anglo-Californian Bank v. Co.*, 7 Mo. App. 77.

Field, 146 Cal. 644, 651 (headnote inadequate); 80 Pac. 1080.

³ E. g. — the name "Adams Express Co." has been held to import a corporation although in fact the company is unincorporated.

⁴ Cf. *Guckert v. Hacke*, 159 Pa. St. 303; 28 Atl. 249 ("Hughes & Gawthrop Co."); *State v. Patterson*, 159 Mo. 98, 101; 59 S. W. 1104 (Adler-Goldman Commission Co.); *Boyce v. Augusta Camp*, 14 Okl. 642; 78 Pac. 322; *Briggs v. McCullough*, 36 Cal. 542, 550 ("Pac. Mut. Life Ins. Co. of Cal."); *Clark v. Jones*, 87 Ala. 474, 481-482; 6 So. 362 ("Wetumpka Lumber Co."); *Cunyus v. Guenther*, 96 Ala. 564; 11 So. 649 ("Penn Mut. Life Ins. Co."); *Austin v. M. Ferst's Sons & Co.* (Ga.), 58 S. E. 318 ("M. Ferst's Sons & Co.").

⁵ *Clark v. German Mut. Fire Ins.*

company's name without the addition of the word "limited," an insertion of the words "if limited" in the application was held insufficient to import a condition into the subscription, on the ground that the name of the company charged the applicant with notice that the company was not limited.¹ This decision was certainly a harsh one, and in view of the fact that a company may use a name other than its proper corporate name, the soundness of the reasoning may well be questioned. Moreover, the facts of the case disclosed another ground on which the decision could be supported.

§ 466. **Change of Corporate Name.** — Where a corporate name is conferred by act of the legislature, it can only be altered by another act of the legislature. Where the company is incorporated under a general law, the name as specified in the incorporation paper can be altered only in the method, if any, provided by statute for making alterations in the incorporation paper.² A statute providing a method for changing the corporate name is repealed by implication by a subsequent statute providing another method for making any change in the incorporation paper.³ The change of name is not complete until all statutory formalities, such as registration of the new name, have been completed.⁴ Thus, until that time, it seems that the company acquires no right to the exclusive use of the new name.⁵ Moreover, until that time, calls are properly made and actions brought in the old name;⁶ and until that time where the new name is so different from the old that a casual reader would not suspect that the same company was designated, a notice of the call given

¹ *Perrett's Case*, 15 Eq. 250.

Oxford, 83 Fed. 288, 296; 28 C. C.

² As to the necessity of changing the corporate name when a change is made in the incorporation paper that would render the old name misleading, see *supra*, § 150 and § 450.

A. 404.

³ *Illinois Watch Case Co. v. Pearson*, 140 Ill. 423; 31 N. E. 400; 16 L. R. A. 429.

⁴ *Fort Pitt B. & L. Ass'n v. Model Plan B. & L. Ass'n*, 159 Pa. St. 308; 28 Atl. 215.

But see *infra*, as to acquiring by user the right to use a trade name other than the true corporate name, § 467.

⁵ As to evidence proving compliance with the statutory requirements, see *Whitman v. National Bank of*

Shackleford, Ford & Co. v. Dangerfield, L. R. 3 C. P. 407.

in the new name would, it seems, bind only those shareholders having knowledge of the change.¹ It has been held that the regularity of proceedings to effect a change in the corporate name cannot be impugned collaterally in a suit to which the corporation is a party.² Where a statute authorizes a change of corporate name only with the consent of a court, the matter is discretionary with the judge, and he may withhold his consent if the new name resembles somewhat the name of another company, even though the resemblance be not so close as to give the latter company an absolute right to prevent the use of the proposed new name.³ Of course a change of name does not affect the identity of the corporation.⁴ It has been said that where the name of a corporation is changed, an action against it by its former name is not irregular;⁵ but the correctness of this assertion is to say the least open to grave doubt,⁶ unless the change of name took place after the action was begun.⁷ An unauthorized attempt to change the corporate name does not dissolve the

¹ *Shackleford, Ford & Co. v. Dangerfield*, L. R. 3 C. P. 407, 411, 412. on changing its name is not required under the domestic law to make a

² *International Savings, etc. Co. v. Stenger*, 31 Pa. Sup. Ct. 294. Cf. *Watts v. Port Deposit*, 46 Md. 500. new designation of an agent for service of process);

³ *United States Mercantile, etc. Agency*, 115 N. Y. 176; 21 N. E. 1034. But see *Robinson v. First National Bank* (Tex.), 79 S. W. 103; *State ex rel. Osborne v. Nichols*, 38 Wash. 309; 80 Pac. 462 (statute providing that no company "hereafter organized" under any other statute should use the word "trust" as part of its name applied to a change of name by a company previously incorporated under another law).

⁴ *Allen v. North Des Moines M. E. Church*, 102 N. W. 808; 127 Iowa 96; 109 Am. St. Rep. 366; 69 L. R. A. 255 (semble); *Wilhite v. Convent of Good Shepherd*, 78 S. W. 138; 25 Ky. L. Rep. 1375; *South Carolina Mutual Ins. Co. v. Price*, 67 S. Car. 207; 45 S. E. 173; *Wright Caesar Tobacco Co. v. A. Hoen & Co.* (Va.), 54 S. E. 309; *Bucksport, etc. R. R. Co. v. Buck*, 68 Me. 81, 84-85; *Howard v. Glenn*, 85 Ga. 238; 11 S. E. 610; 21 Am. St. Rep. 156; *Priest v. Glenn*, 51 Fed. 400; 2 C. C. A. 305; *Young v. South Tradegar Iron Co.*, 85 Tenn. 189, 201 (headline inadequate); 2 S. W. 202; 4 Am. St. Rep. 752; *Cable Co. v. Rathgeber* (S. Dak.), 113 N. W. 88 (holding that foreign corporation

⁵ *Wilhite v. Convent of Good Shepherd*, 78 S. W. 138; 25 Ky. L. Rep. 1375.

⁶ See *Delaware, etc. R. R. Co. v. Irick*, 23 N. J. Law 321, 327; *Gray v. Monongahela Nav. Co.*, 2 Watts & S. (Pa.) 156, 162; 37 Am. Dec. 500; *Young v. South Tradegar Iron Co.*, 85 Tenn. 189, 201-202; 2 S. W. 202; 4 Am. St. Rep. 752.

⁷ *East Tennessee, etc. R. R. Co. v. Evans*, 6 Heisk. (Tenn.) 607.

corporate existence or affect the right to carry on business under the old name.¹

§ 467. **User of Name other than Corporate Name.**— A corporation may by user acquire a trade or business name differing from its corporate name, and may by injunction protect such business name to the same extent as an individual might do in a similar case.² This is true even though the user of such trade name is in contravention of a statute requiring the names of all incorporated limited-liability companies to contain the word "Limited."³ Consequently a corporation may adopt and use the name of a former partnership of which one of its officers was a member, and the fact of such adoption will be sufficient to render a promissory note made in the firm name binding upon the corporation.⁴ Of course the adoption and user of a trade name other than the corporate name does not alter the legal corporate name; and hence an action brought in such adopted name should, if the irregularity be properly pleaded, abate.⁵

§ 468. **Assignment of Right to Use Corporate Name.**— A voluntary assignment by a corporation of the right to use its corporate name has been held *ultra vires* and void.⁶ But an assignment for valuable consideration, by the procuration and with the assent of the individual whose name forms part of the corporate name sought to be transferred, has been held to be effective.⁷ More-

¹ *Richards v. Minnesota Sav. Bank*, 75 Minn. 196, 205 (headnote inadequate); 77 N. W. 822; *O'Donnell v. Johns*, 76 Tex. 362.

² *Philadelphia, etc. Trust Co. v. Philadelphia Trust Co.*, 123 Fed. 534; *H. E. Randall, L't'd v. British & American Shoe Co.* (1902), 2 Ch. 354.

Cf. *Charles S. Higgins Co. v. Higgins Soap Co.*, 144 N. Y. 462; 39 N. E. 490; 3 Am. St. Rep. 769; 27 L. R. A. 42; *People v. Rose*, 219 Ill. 46; 76 N. E. 42.

But see *Sykes v. People*, 132 Ill. 32; 23 N. E. 391 (upon a prosecution for false pretences proof that the name of the defrauded company as stated in the indictment was a popular, trade name and not the legal corporate name held a

fatal variance); *Robinson v. First Nat. Bank* (Tex.), 79 S. W. 103 (a startling decision holding that if the members of a corporation carry on business under a name different from the corporate name, they become liable as partners).

³ *H. E. Randall, L't'd v. British & American Shoe Co.* (1902), 2 Ch. 354.

⁴ *Conro v. Port Henry Iron Co.*, 12 Barb. (N. Y.) 27, 55-56.

⁵ *C. D. & M. Co. v. Keisel*, 43 Iowa 39.

⁶ *Armington v. Palmer*, 21 R. I. 109; 42 Atl. 308; 79 Am. St. Rep. 786; 43 L. R. A. 95.

⁷ *Lamb Knit Goods Co. v. Lamb Glove & Mitten Co.*, 120 Mich. 159; 78 N. W. 1072.

But see *State ex rel. Bradford v.*

over, the right to use the corporate name may pass to purchasers in reorganization proceedings,¹ or to an assignee for the benefit of creditors and from him to his grantee.² An assignment by a corporation of the right to use the corporate name does not entitle the purchasers to an injunction restraining individual shareholders, whose own names form part of the corporate name and who as shareholders have received the benefit of the consideration for the assignment, from establishing a rival business under their own names.³

Western Irrigating Co., 40 Kans. 96, *Marvin Co. v. Hall's Safe Co.*, 208 99 (headnote inadequate); 19 Pac. U. S. 554.
349; 10 Am. St. Rep. 166.

¹ *Peck Bros. & Co. v. Peck Bros. etc. Co.*, 191 Mass. 353.
Co., 113 Fed. 291; 51 C. C. A. 251. ² *Donnell v. Herring-Hall-Marvin*
Cf. Union Mills v. Harder, 116 N. Y. *Co.*, 208 U. S. 267.
App. Div. 22. *Cf. Herring-Hall-*

CHAPTER IX

CORPORATE SEALS

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§ 469—§ 477. WHEN A CORPORATION MUST USE A SEAL.

§ 469. **Nature of Seals in general — Reasons for holding a Corporation bound by its Seal.** — The law of seals and sealed instruments contains embedded in it many curious bits of history, and none more quaint and interesting than those connected with the subject of corporate seals. In former days, each individual had his own peculiar seal or signet which was used for purposes of identification much as signatures are to-day, and every seal was supposed to possess a peculiar virtue and efficacy, so that in the earliest times of our legal history if a man's own proper seal were affixed to an instrument he was bound thereby even though the seal was attached without his authority.¹ A corporation being an intangible, fictitious legal entity, could neither speak nor write, but it might own a seal, which should have this peculiar virtue and efficacy. Since it was not the act of sealing but the ownership of the seal which in those days bound the obligor in a sealed instrument, the corporation, although it had no hands with which it could affix a seal, yet being capable of owning a seal might be bound thereby. Hence it was that the common seal was regarded as of the very essence of a corporation and as constituting the very symbol of the union between its members. This mediæval notion no doubt savored of scholasticism, but it was logical, and harmonized with the doctrines once prevalent as to seals in general as well as with the conception of a corporation as an imaginary legal entity.

§ 470—§ 477. *Of the Doctrine that a Corporation can be bound only by its Seal.*

§ 470. **Reasons for Doctrine.** — A consequence of this theory of a corporation, consistently carried out, was that a body corporate could act and contract in no other way than by the use of its seal. It could not speak, for it had no mouth. It could not write, for it had no hands. It could not make a contract resting for its validity on a "meeting of minds," for it had no mind. It could be bound only by the talismanic virtue of its seal.

§ 471. **Cessation of Reason for Doctrine.** — This doctrine was not merely inconvenient in practice, but also, as the law devel-

¹ 1 Pollock & Maitland's Hist. of Eng. Law, 490.

oped, became illogical in theory. For as time went on, the ancient strictness of the law of seals broke down; and it came to pass that a seal was no longer regarded as possessing in itself the peculiar efficacy and virtue to which we have referred. A man was no longer bound because his own proper seal was affixed; it became necessary to show that the seal was affixed by him or by his authority. When this innovation became established, there was no longer any reason for holding that a corporation could contract by the use of its seal any more than in any other way. For, if a seal was not binding unless intentionally affixed, how was a corporation to be bound by its seal since it had no mind capable of entertaining an intent to affix the same?

§ 472. **Survival of Doctrine after Reason had Ceased.** — This difficulty, of course, never troubled the courts. They continued to hold that a corporation could be bound by a contract under its seal, and also, with unconscious inconsistency, that it could be bound in no other way. Thus, this relic of mediævalism survived after its logical harmony with other parts of the law — its only merit — had passed away. Under those circumstances, it was inevitable that the time-honored rule itself that a corporation could contract only under its common seal, excessively inconvenient as it was, should begin to break down.

§ 473. **Modern English Rule.** — Nevertheless, in England, the old mediæval rule has not been completely abrogated by the courts. To be sure, with respect to corporations formed under the Companies Acts, which constitute the great bulk of modern English corporations engaged in mercantile or financial enterprises, the old rule has been abolished by express statute. That is to say, the Companies Act of 1867 enacts in substance that corporations governed thereby shall be bound by their simple contracts to the same extent as individuals, and that a corporation need use a seal only when an individual would be obliged to do so.¹ But as to other corporations — such as municipal corporations — the old rule is kept up,² subject, however, to certain exceptions.³ As the whole doctrine has been

¹ 30 & 31 Vict. c. 131, § 37. v. *Toronto Milk Co.*, 5 Ont. L.

² See *Lawford v. Billericay Rural Rep.* 1.

Dist. Council (1903), 1 K. B. 772.

³ See 1 Lindley on Companies, As to the Canadian law see *Birney* 6th ed., 271–273, and *infra*, § 476.

fortunately done away with in America, and also in England as to practically all business corporations, a detailed consideration of these exceptions is unnecessary.

§ 474. **Modern American Rule.**—It is unnecessary to narrate in detail the various steps by which in America the courts gradually dispensed with the rule that corporations could act only by the use of the corporate seals. Suffice it to say that at the present time in America nothing whatever is left of the old rule. In the United States, the law is well settled, by judicial decision without the aid of any statute, that a corporation may enter into simple contracts, either oral or in writing, either express or implied in fact, or implied in law; and that a seal is indispensable in the case of a corporation only when by reason of the nature of the instrument it would be requisite in the case of an individual.¹ When by our legal imagination we conjure up a fictitious legal person called a corporation, the imagination must be capable of the additional strain of endowing it not merely with hands to write,² but with a mind to intend and to contract. Hence, a statute dispensing with the necessity for attaching a seal to certain instruments which were required at common law to be under seal applies to corporations as well as to individuals.³ The absence of the corporate seal from any instrument which is not required by law to be under seal is not even a suspicious circumstance sufficient to give warning that the agent who executed the instrument had no authority from the corporation to do so.⁴

¹ *Bank of the Metropolis v. Gutschlick*, 14 Pet. 19; *Union Bank v. Ridgely*, 1 H. & G. (Md.) 324; *St. Clair v. Rutledge*, 115 Wisc. 583; *Griffing Bros. Co. v. Winfield* (Fla.), 43 So. 687; *Crowley v. Genesee Mining Co.*, 55 Cal. 273; *Banks v. Poitiaux*, 3 Rand. (Va.), 136; 15 Am. Dec. 706; 1 Morawetz on Priv. Corps., § 338.

But see *St. Joseph's, etc. Soc. v. St. Hedwig's Church*, 50 Atl. 535; 3 Penn. (Del.) 229.

² Chief Justice Marshall's illogical and historically indefensible doctrine that although a seal is not required a writing is necessary has never been accepted. See *Bank of*

U. S. v. Dandridge, 12 Wheat. 64 (Marshall, C. J., dissenting); *Union Bank v. Ridgely*, 1 H. & G. (Md.) 324.

³ *Ismon v. Loder*, 97 N. W. 769; 135 Mich. 345.

But see *Savannah, etc. R. R. Co. v. Lancaster*, 62 Ala. 555, 564 (head-note inadequate).

As to a statute dispensing with the necessity for the use of a seal except in the case of a corporation, see *Strop v. Hughes* (Mo.), 101 S. W. 146; *Pullis v. Pullis*, 157 Mo. 565; 57 S. W. 1095; *Garrett v. Belmont Land Co.* (Tenn.), 29 S. W. 726; 94 Tenn. 459.

⁴ *Cook v. Am. Tubing, etc. Co.* (R.

§ 475. **Seal as Substitute for an Oath.** — In one or two instances, dependent, however, upon special historical reasons, a corporation must still use a seal where an individual would not be required to do so. For instance, except where the rule has been altered by statute, an answer of a corporation to a bill in equity must be under the corporate seal.¹ In this case, however, the seal is required as a substitute for an oath which was necessary where the defendant was an individual. To be sure, the seal was a poor substitute for an oath, but according to the mediæval mind it was the best that could be found.² The expedient of requiring an oath by the president, or other executive officer of the corporation familiar with its affairs, seems not to have occurred to lawyers of former days, but in a similar case not concluded by ancient precedent would be undoubtedly adopted by modern lawyers and judges in preference to the fictitious solemnity of the seal.³ On principle, the argument might well be accepted that modern statutes dis-

I.), 65 Atl. 641; *Sheffield v. Johnson* Co., 27 App. D. C. 59, 63 (semble) *County Sav. Bank* (Ga.), 58 S. E. 386. *Chequasset Lumber Co.*, 112 Fed. 56;

Cf. *Templeton v. Hayward*, 65 Ill. 178. *Fayette Land Co. v. Louisville, etc. R. R. Co.*, 93 Va. 274; 24 S. E. 1016;

¹ *Williams Co. v. U. S. Baking Co.*, 86 Md. 475; 38 Atl. 990; *State v. Florida Central R. R. Co.*, 15 Fla. 690, 697; *Gildersleeve v. Wolf Island Ry., etc. Co.*, 3 Ch. Chamber Rep. (Ont.) 358 (holding also that the company's solicitor has no authority to affix the seal). *Norwich Pharmacal Co. v. Abaly* (Wisc.), 113 N. W. 962.

Cf. the modern practice, referred to in Langdell on Equity Pleading, 2d ed., pp. 83-84, of making one or more officers co-defendants with the corporation for the purpose of getting discovery from them. See also as to this practice *Roanoke Street Ry. Co. v. Hicks*, 32 S. E. 295; 96 Va. 510 (holding that bill for discovery cannot be maintained against a corporation since it cannot answer under oath, and that if discovery is desired an officer must be made defendant notwithstanding the usual rule that a mere witness cannot be made defendant in order to get discovery from him); *Nixon v. Clear Creek Lumber Co.* (Ala.), 43 So. 805. So also, a corporation's bill for an injunction is to be verified rather by the affidavit of an officer than by the corporate seal; *George's Creek Co. v. Detmold*, 1 Md. Ch. 371, 381-382 657; *Martin v. Martin & Browne* (affidavit of treasurer).

Any seal — for example, a mere wafer — adopted for this particular purpose will as in other cases serve as well as the regular common seal; *Ransom v. Stonington Sav. Bank*, 2 Beasl. (N. J.) 212.

² But an answer of a corporation under its seal does not have the same effect as evidence as the sworn answer of an individual defendant: *Maryland, etc. Iron Co. v. Wingert*, 8 Gill (Md.) 170, 178; *Lovett v. Steam Saw Mill Ass'n*, 6 Paige (N. Y.) 54, 58-59; Langdell on Equity Pleading, 2d ed., p. 84.

³ E. g. *Jacobs v. Mexican Sugar Refining Co.*, 112 N. Y. App. Div. 657; *Martin v. Martin & Browne*

(affidavit of treasurer).

pending with the necessity of sworn answers to bills in equity should by implication relieve corporation defendants from the requirement of a seal; but the courts have not adopted this view.¹ Of course, pleadings of a corporation other than an answer in equity, either at law or in equity, are not required to be under the corporate seal.² The only possible exception would have been pleas in abatement and the like which in the case of an individual would be required to be sworn to.

§ 476. **Statutory and other Provisions requiring certain Contracts of Corporations to be under Seal.** — Even where some particular kind of contract is, by a company's special act of incorporation, or by the incorporation paper, specifically required to be under seal, some American courts hold that a contract of that sort may nevertheless be binding although not under seal, the provision being construed as directory in nature.³ Other American authorities, however, reach a different conclusion.⁴

In England, this precise question must arise, if at all, under somewhat different conditions. In that country, a statute requiring certain contracts of companies to be under seal would

¹ *Williams Co. v. U. S. Baking Co.*, 86 Md. 475; 38 Atl. 990 (where this argument might have been, but apparently was not advanced by the counsel for the losing side). 345; 15 Am. Rep. 612; *New England Fire, etc. Ins. Co. v. Robinson*, 25 Ind. 536; *Barnes v. Ontario Bank*, 19 N. Y. 152.

² *Washington Nat., etc. Ass'n v. Buser* (W. Va.), 57 So. E. 40 (bill in equity); *George's Creek Co. v. Detmold*, 1 Md. Ch. 371 (bill for injunction).

Cape Sable Company's Case, 3 Bland Ch. (Md.) 606, 610-613, holding that authority to confess judgment must be under the corporate seal, would not be followed at the present day. See *Ford v. Hill*, 92 Wisc. 188, 198; 66 N. W. 115; 53 Am. St. Rep. 902; *Thew v. Porcelain Mfg. Co.*, 5 S. Car. 415, 428.

³ *Cahill v. Maryland Life Ins. Co.*, 90 Md. 333, 346-347; 45 Atl. 180; 47 L. R. A. 614.

Cf. *Norwich Yarn Co.*, 22 Beav. 143 (clause in deed of settlement requiring all cheques to be signed by three directors held directory); *Dayton Ins. Co. v. Kelly*, 24 Oh. St.

⁴ *Lindauer v. Delaware Mut. Safety Ins. Co.*, 13 Ark. 461.

Cf. *Allen v. Brown*, 6 Kans. App. 704; 50 Pac. 505; *Foulke v. San Diego, etc. R. R. Co.*, 51 Cal. 365 (statute providing that no contract of the company shall be binding unless in writing held to apply only to wholly executory contracts); *Pixley v. Western Pacific R. R. Co.*, 33 Cal. 183 (same point as last case); *Curtis v. Piedmont Lumber, etc. Co.*, 109 N. Car. 401; 13 S. E. 944 (similar point to that of last case); *Clowe v. Pine Product Co.*, 114 N. Car. 304; 19 S. E. 153 (similar point to that of last two cases); *Roberts v. Deming Woodworking Co.*, 111 N. Car. 432; 16 S. E. 415 (applying the same statute involved in last two cases); *Head v. Providence Ins. Co.*, 2 Cranch 127, 167-169.

be regarded merely as reverting *pro hac vice* to the rule of English common law whereby all contracts were required to be under seal. In any such case, therefore, an unsealed contract would be void.¹ The tendency of the English courts in other cases is to regard as merely directory regulations in a statute or in a company's memorandum or articles prescribing a certain form for contracts of the company.² Even if the provision be held to be mandatory, failure to comply while fatal at law might not have the same effect in all circumstances in equity. Thus, where a contract is required to be under seal either by the English common law rule, or probably by a statute, nevertheless if the subject-matter and circumstances are such that specific performance might be decreed if the parties were individuals, a court of equity, if the contract although not under seal has been partly performed, may decree specific performance.³ The mere fact that because of the absence of a seal the contract is unenforceable at law is no ground for equitable intervention.⁴ According to the latest authority, the absence of a seal will not prevent a recovery against the corporation, even at law, if the contract has been fully performed by the other party.⁵

§ 477. **Survivals of some Consequences of old Rule.** — Whilst with such merely apparent exceptions as are noted in a former paragraph, there is nothing left in the United States of the rule that a corporation can act and contract only under its seal, yet some of the consequences and corollaries of the old doctrine still survive. For instance, corporations still are accustomed to affix their seals to all their more important contracts, although individuals in making similar contracts would be much less

¹ *Crampton v. Varna Ry. Co.*, 7 Ch. 562 (semble). *Laird v. Birkenhead Ry. Co.*, Johns. 500; *London & Birmingham Ry. Co. v. Winter*, Cr. & Ph. 57; *Stevens Hospital v. Dyas*, 15 Ir. Ch. 405; *Marshall v. Corporation of Queensborough*, 1 Sim. & Stu. 520; *Maxwell v. Dulwich College*, 7 Sim. 222 n.; 1 Lindley on Companies, 6th ed., 272.

² Cf. *Prince of Wales' Co. v. Harding*, E., B. & E. 183; *Norwich Yarn Co.*, 22 Beav. 143 (provision requiring cheques to be signed by three directors); *Ridley v. Plymouth Baking Co.*, 2 Ex. 711. *Crampton v. Varna Ry. Co.*, 7 Ch. 562.

³ *Crook v. Seaford*, 6 Ch. 551; *Melbourne Banking Corp. v. Brougham*, 4 A. C. 156, 168-169; *Wilson v. West Hartlepool Ry. Co.*, 2 De G. & Sm. 475; *Earl of Lindsey v. Great Northern Ry. Co.*, 10 Hare 664; *Lawford v. Billericay Rural District Council* (1903), 1 K. B. 772. But see 1 Lindley on Companies, 6 ed., 270.

likely so to do. Moreover, the law of sealed instruments executed by corporations differs in some respects, which will be presently considered in detail, from the law of specialties executed by individuals.

§ 478—§ 482. *What is the Corporate Seal.*

§ 478. **Practice of Corporations to have their own Seals for use on all Occasions.** — In ancient times, each individual had his own seal or signet, and each corporation naturally did the like. Nowadays, an individual never thinks of having his own seal to affix to all legal documents, but whenever he has occasion to execute a specialty adopts a seal for the purpose. Every well organized corporation, however, still has its own seal of some peculiar device with which it executes all instruments requiring a seal.¹

§ 479. **How Corporate Seal is adopted or altered.** — Some general incorporation laws require a description of the corporate seal to be inserted in the memorandum of association or incorporation paper;² but more generally the directors after the organization of the company adopt a seal of a particular description as the company's common seal. Possibly, where the seal is adopted in and by the incorporation paper, no other seal could be adopted by the company. But ordinarily the company has power to alter its seal at pleasure. A seal may be adopted by usage without a formal resolution of adoption.³

§ 480. **Whether Corporation may have several Corporate Seals at same Time.** — In England, apparently, the corporate seal consists in an impression of a particular stamp or die which is carefully kept at the company's principal office, and without this no instrument is deemed to be the deed of the company. To enable a company to keep in different places several duplicate stamps or dies an impression from any one of which shall constitute the corporate seal, express statutory sanction seems to have been thought necessary.⁴ The statute referred to⁵ author-

¹ As to the distinction between a "common seal" or corporate seal and a single piece of wax adopted by each of several persons as his seal, see *Cooch v. Goodman*, 2 Q. B. 580.

² *Vawter v. Franklin College*, 53 Ind. 88.

³ *Mickey v. Stratton*, 5 Sawy. 475 (headnote inadequate); *McRae v. Corbett*, 6 Manitoba 426.

⁴ Cf. *Woodhill v. Sullivan*, 14 C. P. (Up. Can.) 265, 272.

⁵ Companies Seals Act, 1864; 27 Vict., c. 19.

izes British corporations doing business in foreign countries to keep abroad duplicate stamps of their seals. The idea that this statute was necessary must have originated in a doubt whether at common law a corporation could at any one time have more than one stamp for its seal. But this doubt is without foundation in reasons applicable to modern conditions of the law or even in historical considerations; and in the United States the practice is constantly followed without any statutory sanction.

§ 481. **Adoption of Seal for particular Transaction — Use of other than Corporate Seal.** — Since a corporation may alter its seal at pleasure, it may adopt a seal for a particular transaction.¹ Accordingly, in jurisdictions where a mere scroll or flourish of the pen is treated as a seal, a corporation may in executing an instrument adopt as its seal *pro hac vice* a mere scroll² or a printed *fac simile* of an impression of its regular seal. Even if the corporation has a regular common seal, the power of the company itself or of its directors to adopt a different seal for a particular purpose is not open to question.³ *A fortiori*, the use of the letters "L. S." in the record of a deed in a public registry is a sufficient indication, if the grantor be a corporation, that the deed was under the corporate seal.⁴ Even where a statute provides that every company shall have its name "engraved" in legible characters upon its seal, a seal consisting of a piece of adhesive paper with the corporate name printed thereon may

¹ *Mill Dam Foundry v. Howey*, 21 Pick. (Mass.) 417, 428; *Porter v. Androscoggin, etc. R. R. Co.*, 37 Me. 349.

As to the effect of a failure of a corporate seal to comply with a statutory form: *City of Defiance v. Schmidt*, 123 Fed. 1; 59 C. C. A. 159.

² *Jacksonville, etc. Ry. Co. v. Hooper*, 160 U. S. 514 (headnote inadequate); 16 Sup. Ct. 379.

³ "Although it be a Corporation that doth make the deed, yet they may seale with any other seal besides their common seale, and the deed never the worse." Touchstone of Common Assurances, 57.

Accord: *Bank of Middlebury v. Rutland, etc. R. R. Co.*, 30 Vt. 159; *Tenney v. East Warren Lumber Co.*,

43 N. H. 343; *Sarmiento v. Boat & Oar Co.*, 105 Mich. 300; 63 N. W. 205; 55 Am. St. Rep. 446 (where the objection that a statute had deprived corporations of this power was overruled); *District of Columbia v. Camden Iron Works*, 181 U. S. 453; 21 Sup. Ct. 680; *G. V. B. Mining Co. v. First Nat. Bank*, 95 Fed. 23; 36 C. C. A. 633 (notwithstanding by-laws requiring the regular corporate seal to be affixed).

Cf. *Stebbins v. Merritt*, 10 Cush. (Mass.) 27, 34-35; *South Baptist Soc. v. Clapp*, 35 Barb. (N. Y.) 35, 49.

But see *Savings Bank v. Davis*, 8 Conn. 191.

⁴ *Altschul v. Casey*, 76 Pac. 1083; 45 Oreg. 182.

be a good seal.¹ But when a corporation has a regular stamp for its corporate seal, does any officer or agent who has authority to affix that seal also possess authority to adopt some other seal, such as a scroll, as the seal of the corporation for a particular purpose? Logically, perhaps he does not, but the courts at this day would be unlikely to hold an instrument void on that ground.² The circumstance, however, that a mere printed representation of a seal, instead of an impression of the regular corporate seal is annexed to a paper may be sufficient evidence, especially when coupled with other facts tending in the same direction, to justify the court in holding, even in jurisdictions where a scroll is a good seal, that the emblem or print was not intended as a seal.³

§ 482. *Seal must be adopted as Seal of Corporation and not as Seal of Officer or Agent affixing it.* — Of course, in order that a corporation may be bound by a deed as a party thereto, the seal must be that of the corporation, and must have been adopted as such either generally or for that particular purpose. Hence, if the private seals of the members are attached, the instrument is not the deed of the corporation.⁴ In determining whether the seal affixed to a paper is to be deemed the seal of the corporation or of the agent by whom the instrument was executed, the same considerations control as in any other case of principal and agent, except that the fact that a corporation has a regular seal which is not used may be some evidence that the

¹ *Hoe v. Lee*, 3 N. So. Wales State Rep. 30.

² *Sarmiento v. Davis Boat & Oar Co.*, 105 Mich. 300; 63 N. W. 205; 55 Am. St. Rep. 446.

But see *Savings Bank v. Davis*, 8 Conn. 191, 206.

³ *Jackson v. Myers*, 43 Md. 452; *Muth v. Dolfeld*, 43 Md. 466.

See *infra*, § 485.

⁴ *Bank of Columbia v. Patterson*, 7 Cranch 299, 304 (headnote inadequate); *Randall v. Van Vechten*, 19 Johns. (N. Y.) 60; 10 Am. Dec. 193; *Tippets v. Walker*, 4 Mass. 595; *Brinley v. Mann*, 2 Cush. (Mass.) 337; 48 Am. Dec. 669; *Osborne v. Tunis*, 25 N. J. Law 633; *Taft v. Brewster*, 9 Johns. 334; 6 Am. Dec. 280; *Mitchell v.*

St. Andrew's Bay Land Co., 4 Fla. 200.

But see *Taylor v. Heggie*, 83 N. Car. 244; *Johnston v. Crawley*, 25 Ga. 316 (headnote inadequate); 71 Am. Dec. 173.

Cf. *Ismon v. Loder*, 97 N. W. 769; 135 Mich. 345; *Harvey v. Board of Trustees*, 142 Cal. 391; 75 Pac. 1086; *District of Columbia v. Camden Iron Works*, 181 U.S. 453; 21 Sup. Ct. 680.

In *Wiley v. Board of Education*, 11 Minn. 371, the court held an averment that the corporation by its duly elected and qualified officers under *their* hands and seals had executed an instrument to be on demurrer a sufficient allegation of execution by the corporation; *sed quære de hoc.*

seal actually affixed was rather to be deemed that of the agent. Moreover, the mere fact that an impression of the corporate seal was made opposite the name of each agent who signed the paper on the company's behalf does not show that the seal was intended as the private seal of the agents rather than the common seal of the corporation.¹

§ 483. **Authority to affix Corporate Seal — How conferred.** — Since a corporation, being an intangible legal entity, cannot act in person, necessarily the corporate seal must be attached by agents. If the rule that authority to affix a seal must itself be under seal were strictly applied to corporations, no corporation could execute a specialty. Being an imaginary entity, it could not in proper person affix its seal either to the instrument itself or to a power of attorney to execute the instrument. To be sure, it might be held that the affixing of the seal at a meeting of the directors or shareholders should be deemed equivalent to execution by the corporation in person, while sealing by inferior agents should require a sealed power of attorney; and to this effect are some English authorities.² But this distinction has fortunately never been taken in America; and accordingly, the law has been generally laid down that authority to affix a corporate seal may be conferred by parol³ or implied from the practice of the

¹ *Jackson ex dem. Donally v. Walsh*, 3 Johns. (N. Y.) 226.

Cf. *Johnston v. Crawley*, 25 Ga. 316; 71 Am. Dec. 173; *City of Kansas v. Hannibal, etc. R. R. Co.*, 77 Mo. 180; *Tenney v. East Warren Lumber Co.*, 43 N. H. 343.

² Cf. *Mayor, etc. of Merchants of Staple v. Bank of England*, 21 Q. B. D. 160, 165–166, per Wills, J., citing Brooke's Abr. Tit. "Corp." pl. 72, and Y. B., 9 Edw. IV, p. 39, which last mentioned authority hardly bears out the inferences drawn from it, but relates rather to the question whether a deed of a convent is good, which on its face purports to have been made in the convent, when in fact it was made outside by virtue of a letter of attorney. It is much to be regretted that Mr. Norton in his recent valuable treatise should have lent the weight of his authority to the view that a deed of a corporation must be executed either at a corporate meeting or in pursuance of a sealed power of attorney. Norton on Deeds, 13. Even Mr. Norton admits that by custom deeds of trading corporations may be executed and delivered in pursuance of parol authority.

³ *Hopkins v. Gallatin Turnpike Co.*, 4 Humph. (Tenn.) 403, 411; *Beckwith v. Windsor Mfg. Co.*, 14 Conn. 594; *Hutchins v. Byrnes*, 9 Gray

company.¹ The question in each case is whether the officer or agent by whom the instrument was executed had in fact authority to affix the seal.² It is immaterial how that authority was conferred, whether expressly or impliedly, orally or in writing. A consequence of this rule is that any agent who has authority to affix the seal may fill up blanks in a deed after it has been sealed.³ Moreover, where a person without authority affixes the corporate seal, his act may be ratified by parol or by mere acquiescence so as to render the instrument binding upon the corporation as its deed.⁴ An act of incorporation providing that the members of the company may "order and dispose of the custody of their common seal and the use and application thereof" merely empowers them to make rules for the custody of the seal, and does not require their concurrence in each special act of sealing, or restrain them from delegating to an agent authority to affix the seal.⁵ Indeed, a statute specially pointing out a mode of conferring authority to affix the corporate seal will if possible be construed as directory so as not to exclude any method that would have been good at common law.⁶

§ 484. **Whether Deed of a Corporation requires Delivery.** — There is an ancient legal tradition that a deed of a corporation needs no delivery, but is complete on the affixing of the common seal.⁷ This tradition has been repeated in a number of modern

(Mass.) 367; *Zihlman v. Cumberland Glass Co.*, 74 Md. 303; 22 Atl. 271 (oral authority sufficient). *Keil*, 20 Minn. 531. See also *infra*, § 491.

Cf. *Uvalde Paving Co. v. City of New York*, 99 N. Y. App. Div. 327; 91 N. Y. Supp. 131.

¹ *Barned's Banking Co.*, 3 Ch. 105; *Hutchins v. Byrnes*, 9 Gray (Mass.) 367.

² As to presumptions of authority to affix corporate seal, see *infra*, § 490.

³ *Barned's Banking Co.*, 3 Ch. 105.

⁴ *Howe v. Keeler*, 27 Conn. 538; *St. James Parish v. Newburyport, etc. R. R. Co.*, 141 Mass. 500; 6 N. E. 749.

⁵ *Hill v. Manchester, etc. Water Works Co.*, 5 B. & Ad. 866, 874.

⁶ *Bason v. King's Mountain Mining Co.*, 90 N. Car. 417; *Morris v.*

⁷ The first appearance of this tradition in our books, so far as the writer is aware, is found in the argument of counsel for the defendant in *Willis v. Jermin*, Cro. Eliz. 167. The argument did not prevail with the court, and the supposed distinction between deeds of corporations and of natural persons was expressly disapproved by at least one of the judges. The headnote to the modern editions misrepresents the position of the court. See another report of the case in 2 Leon. 97. The same contention was advanced by the counsel for the defendant in the *Case of the Deane and Chapter of Fernes*, Davis 42, 44: "Et le fait de un Corporation ne besoine delivery, come le fait de un natural person, mes le

English dicta.¹ Perhaps, it originated in the time when the mere use of a person's seal even without his consent and *a fortiori* without delivery was, even in the case of an individual, sufficient to make a completed deed, being kept alive by a notion that a corporation, an intangible entity, was incapable of delivering a paper. However this may be, certain it is that in modern times the supposed doctrine has no basis in reason. For the law has long been settled that the mere affixing of the corporate seal without the authority of the company or its duly constituted officers or agents does not make a paper the deed of the corporation,² so that the mere presence of the seal on the document has no longer any talismanic virtue. Indeed, the authorities now agree that the doctrine that no delivery is essential applies only when the intent is that the instrument shall operate as a completed deed from the affixing of the seal without further ceremony.³ Thus qualified, the supposed doctrine is not merely illogical in its relation to other parts of the modern law of sealed contracts, but is also without historic justification; and accordingly it is submitted that the whole doctrine should be thrown overboard, and deeds of corporations placed on the same footing with respect to the necessity for delivery as the deeds of in-

apposition del common Seale done perfection a ceo solement." It will be noticed that judgment was given for the plaintiff; but the passage quoted has often been referred to with approval as though it were the decision of the court.

See Roll. Abr. Tit. Fait (I), p. 23, l. 50; 4 Cruise Dig. tit. XXXII. ch. II, § 70; Grant on Corporations, 63, 147-148; Angell & Ames on Corps., ch. VII, § 9; 4 Thompson, Comm. on Corps., § 5093. The supposed doctrine, however, has never been made the basis of an actual decision in any reported case. Moreover, in the time of Edward IV, it seems to have been assumed that the deed of a corporation, like the deed of a natural person, requires delivery. Y. B. 9 Edw. IV, p. 39.

¹ *Derby Canal v. Wilmot*, 9 East, 360; *Gartside v. Silkstone, etc. Co.*, 21 Ch. D. 762, 768.

See also *Bason v. King's Moun-*

tain Mining Co., 90 N. Car. 417, 421 (semble).

But see *Mayor, etc. of Merchants of the Staple v. Bank of England*, 21 Q. B. D. 160, 165-166 (where Wills, J., said that a deed of a corporation requires delivery and that the delivery must take place at a meeting of the corporation unless there be a power of attorney to effect the delivery).

² *Anonymous*, 12 Mod. 423, Case 728, per Holt, C. J.; *Case of the Deane and Chapter of Fernes*, Davis 43; *Mayor, etc. of Merchants of the Staple v. Bank of England*, 21 Q. B. D. 160.

³ *Derby Canal v. Wilmot*, 9 East 360; *Gartside v. Silkstone, etc. Co.*, 21 Ch. D. 762, 768.

Cf. *Willis v. Jermin*, Cro. Eliz. 167; s. c., 2 Leon. 97; *Anonymous*, 1 Ventr. 257; *Good v. Ash*, 3 Keb. 307.

dividuals. That this result would be reached in the United States there can be little or no doubt,¹ and indeed even in England it appears to have been virtually attained in the latest case upon the subject.² As the time-honored doctrine is supported only by a concatenation of dicta originating in an argument of a losing counsel, the courts need hesitate the less in putting the law on a modern basis.³

§ 485-§ 486. *Effect of Use of Seal by a Corporation.*

§ 485. **Instrument under Corporate Seal a Specialty.** — The effect of attaching a seal to an instrument executed by a corporation is precisely the same as if the maker had been an individual.⁴ To be sure, an idea is prevalent that the affixture of the corporate seal is merely a corporation's way of signing its name; but this notion, it is submitted, is not correct. The distinction between parol contracts and instruments under seal is not obliterated in the case of corporations. A contract under the corporate seal is a specialty: the form of action thereon, where forms of action still exist, must be debt or covenant and not assumpsit;⁵ and the statute of limitations is that applicable to sealed instead of unsealed contracts. It is true that bonds and debentures under the corporate seal are negotiable while the presence of a seal is fatal to the negotiability of an individual's note or bill. But this distinction properly rests on the custom of merchants, which

¹ Cf. *Holmes v. Salamanca Gold, etc. Co.* (Cal.), 91 Pac. 160 (where a deed executed by a corporation was held ineffective for want of delivery but without discussion of the point now under consideration). See, however, dictum in North Carolina case cited supra, p. 401, n. 1.

² *Mowatt v. Castle Steel, etc. Co.*, 34 Ch. D. 58, 62.

Cf. *Willis v. Jermin*, Cro. Eliz. 167, per Gawdy, J.; s. c., 2 Leon. 97.

³ See Norton on Deeds, 9-11, where the learned author carefully discusses the English authorities and reaches the conclusion that the supposed distinction between deeds of corporations and deeds of individuals is baseless and should not be applied by the courts.

⁴ *Clark v. Farmers Mfg. Co.*, 15 Wend. (N. Y.) 256.

⁵ *Porter v. Androscoggin, etc. R. Co.*, 37 Me. 349; *Brown v. Commercial Fire Ins. Co.*, 21 App. D. C. 325, 335 (semble); *Marine Ins. Co. v. Young*, 1 Cranch 332.

But see *Levering v. Mayor, etc. of Memphis*, 7 Humph. (Tenn.) 553. It is submitted that this case should be supported upon the ground that from the nature of the paper — a mere letter accepting a parol offer — the court can see that the so-called seal affixed thereto was really not intended as a seal.

Cf. *Brown v. Commercial Fire Ins. Co.*, 21 App. D. C. 325, 335-337.

treats such securities when issued by corporations as negotiable.¹ In spite of their negotiability, they are still specialties. It is also true that in some cases the presence of a printed representation of a seal upon a paper executed by a corporation, even in jurisdictions where a scroll is a good seal, has been held not to have the effect of making the instrument a specialty.² But these cases should be supported upon the ground that the symbol or emblem was never intended for the seal of the company, and do not establish that an instrument under the corporate seal can be treated as other than a specialty.

§ 486. **Whether Sealed Contract of a Corporation requires a Consideration.** — A contract under seal of course requires no consideration to support it, and this rule applies to the sealed contracts of corporations as well as those of individuals.³ To be sure, contracts without consideration are generally *ultra vires*, and the presence of the seal does not preclude inquiry into the question whether or not the contract was within the company's powers.⁴ A sealed contract of a corporation is neither more nor less binding because of the want of consideration: if

¹ *Infra*, § 1734, § 1735.

² *Jackson v. Myers*, 43 Md. 452; *Muth v. Dolfeld*, 43 Md. 466; *Metropolitan Life Ins. Co. v. Anderson*, 79 Md. 375, 379; 29 Atl. 606.

With perhaps doubtful propriety, the same conclusion has been reached where the instrument bears an impress of the regular corporate seal but does not in the body thereof purport to be under seal. *Ham-burger v. Miller*, 48 Md. 317, 323; *Bank v. Railroad Co.*, 5 S. Car. 156; 22 Am. Rep. 12; *Weeks v. Esler*, 68 Hun (N. Y.) 518; 22 N. Y. Supp. 54 (proceeding at least in part upon the ground that the seal was not proved to have been affixed by due authority).

Cf. *Brown v. Commercial Fire Ins. Co.*, 21 App. D. C. 325, 335–337 (where an impression of a seal in the upper corner of the instrument over certain figures was held to have been intended to protect the figures from alteration and not as a true seal); *Mackay v. St. Mary's Church*, 15

R. I. 121; 23 Atl. 108; 2 Am. St. Rep. 881 (where a "paper seal," not the regular corporate seal, was when attached to a promissory note held "a piece of unnecessary ornament").

³ *Royal Bank v. Grand Junction R. R. Co.*, 100 Mass. 444, 445 (headnote inadequate); 97 Am. Dec. 115; *Brooks, Jenkins & Co. v. Mayor, etc. of Torquay* (1902), 1 K. B. 601, 607 (headnote inadequate).

Cf. *Sturtevant v. City of Alton*, 3 McLean, 393, 395.

⁴ Cf. *Mayor, etc. of Norwich v. Norfolk Ry. Co.*, 4 E. & B. 397, 443–444. As the contract is under the corporate seal and on its face binding upon the company, it would seem that the burden of proving that the contract was without consideration and therefore *ultra vires* should rest upon the corporation. But see 1 Morawetz on Priv. Corps., 2d ed., § 241, where the learned author argues in support of a contrary view on this point.

require it,¹ — at any rate, not unless the other party be proved to have notice of the by-laws. If, however, a statute require deeds of corporations to be countersigned or “attested” by the secretary, it has been held that the record of a deed not so authenticated will not operate as constructive notice.²

§ 489. **Of the Presumption that Seal attached to Instrument duly signed on behalf of Corporation is Seal of Corporation.** — If an instrument in the body thereof contemplates sealing by the corporation, and is proved to have been subscribed on behalf of the corporation by its president or other duly qualified officer, and if a seal is affixed thereto purporting to be the seal of the corporation, it will be presumed genuine in the absence of evidence to the contrary.³ Even if under circumstances similar to the above the seal is shown to be not the regular corporate seal but a mere wafer or even (in jurisdictions where a scroll may be used as a seal) a scroll or printed emblem, it will nevertheless be presumed to have been adopted *pro hac vice* as the seal of the corporation.⁴ This presumption, however, will not be indulged, it seems, where from the nature of the instrument or from other circumstances the court infers that the document was not intended to be under seal:⁵ in such cases, the printed device or representation of a seal will be presumed to be rather a

¹ *Smith v. Smith*, 62 Ill. 493.

² *Randall Co. v. Glendenning* (Okla.), 92 Pac. 158.

³ *Susquehanna Bridge, etc. Co. v. General Ins. Co.*, 3 Md. 305; 56 Am. Dec. 740; *Phillips v. Coffee*, 17 Ill. 154; 63 Am. Dec. 357; *Woodman v. York, etc. R. R. Co.*, 50 Me. 549; *Wagg-Anderson Woolen Co. v. Leshner & Co.*, 78 Ill. App. 678; *Chicago, etc. R. R. Co. v. Lewis*, 53 Iowa 101; 4 N. W. 842.

Cf. *City Council v. Jane Moorehead*, 2 Rich. Law (S. Car.) 430; Norton on Deeds, 21.

But see *Moises v. Thornton*, 8 T. R. 303; *Mann v. Pentz*, 2 Sandf. Ch. (N. Y.) 257.

⁴ *Jacksonville, etc. Ry. Co. v. Hooper*, 160 U. S. 514, 518 (headnote inadequate); 16 Sup. Ct. 379; *Mill Dam Foundry v. Howey*, 21

Pick. (Mass.) 417, 428; *City of Kansas v. Hannibal, etc. R. R. Co.*, 77 Mo. 180; *Stebbins v. Merritt*, 10 Cush. (Mass.) 27, 34–35 (headnote inadequate); *Tenney v. East Warren Lumber Co.*, 43 N. H. 343; *Benbow v. Cook*, 115 N. Car. 324; 20 S. E. 453; 44 Am. St. Rep. 454; *Ellison v. Branstrator*, 54 N. E. 433; 153 Ind. 146; *Griffing Bros. Co. v. Winfield* (Fla.) 43 So. 687, 689 (headnote inadequate).

Cf. *Crossman v. Hilltown Turnpike Co.*, 3 Grant's Cas. (Pa.) 225; *Gashwiler v. Willis*, 33 Cal. 11; 91 Am. Dec. 607.

⁵ *Jackson v. Myers*, 43 Md. 452; *Muth v. Dolfield*, 43 Md. 466; *Metropolitan Life Ins. Co. v. Anderson*, 79 Md. 375, 379; 29 Atl. 606. Cf. *supra*, § 485.

mere ornament or to be used much as stamped letter-paper is used by every business firm.

§ 490. **Proof that Seal was affixed by competent Authority — Presumptions.** — In order that an instrument shall be operative as the deed of the corporation, not merely must the seal attached be proved to be the seal of the corporation but it must also have been affixed by proper authority.¹ Where the seal was affixed by the officer having due custody thereof, the presumption is that it was affixed by competent authority.² We have seen above that such authority need not be itself under seal.³ Accordingly, evidence that a certain agent was accustomed to affix the seal is if uncontradicted and unexplained sufficient evidence of authority to do so. Moreover, if the seal affixed is shown to be an impression from the regular corporate seal, the presumption is that it was affixed by competent authority.⁴ The

¹ *Koehler v. Black River, etc. Co.*, 58 S. E. 697 (deed signed by treasurer).
² Black 715. See *supra*, § 471, § 472, § 483.

As to whether the corporation can be estopped by negligence in the custody of the seal from denying that it was affixed by competent authority, see *Mayor, etc. of Merchants of the Staple v. Bank of England*, 21 Q. B. D. 160; *Bank of Ireland v. Trustees of Evans' Charities*, 5 H. L. Cas. 389.

³ *Hopkins v. Gallatin Turnpike Co.*, 4 Humph. (Tenn.) 403; *Fidelity Ins. Co. v. Shenandoah Valley R. Co.*, 32 W. Va. 244; 90 S. E. 180; *Ellison v. Branstrator*, 54 N. E. 433; 153 Ind. 146; *Bliss v. Harris* (Colo.), 87 Pac. 1076 (secretary the lawful custodian of the seal); *Watkins v. Glas* (Cal.), 89 Pac. 840, 843; *Evans v. Lee*, 11 Nevada 194 (secretary custodian of seal); *Joel T. Bailey & Co. v. Snyder Bros.*, 61 Ill. App. 472 (semble, where instrument signed by president and secretary); *Mullanphy Sav. Bank v. Schott*, 135 Ill. 655, 666 (bonds and mortgage signed by secretary and by president); *Underhill v. Santa Barbara, etc. Co.*, 93 Cal. 300, 314 (seal affixed by secretary); *Nelson v. Spence* (Ga.),

58 S. E. 697 (deed signed by treasurer).

Cf. *Jackson v. Campbell*, 5 Wend. (N. Y.) 572 (where the presumption was rebutted); *Graham v. Partee* (Ala.), 35 So. 1016; 139 Ala. 310; 101 Am. St. Rep. 32 (where the name of the corporation was not subscribed to the deed); *Bliss v. Kaweah, etc. Co.*, 65 Cal. 502 (where the presumption was rebutted); *Smith v. Smith*, 117 Mass. 72 (where the presumption was rebutted).

⁴ *Supra*, § 483.

⁴ *Berks & Dauphin Turnpike Road v. Myers*, 6 S. & R. (Pa.) 12; 9 Am. Dec. 402; *Darnall v. Dickens*, 4 Yerg. (Tenn.) 7; *Barned's Banking Co.*, 3 Ch. 105, 116; *Mickey v. Stratton*, 5 Sawy. 475; *Indianapolis, etc. R. R. Co. v. Morganstern*, 103 Ill. 149; *Leggett v. New Jersey, etc. Banking Co.*, 1 N. J. Eq. 541; 23 Am. Dec. 728; *Yanish v. Pioneer Fuel Co.*, 64 Minn. 175; 66 N. W. 198; *Gorder v. Plattsmouth, etc. Co.*, 36 Nebr. 548; 54 N. W. 830; *Levering v. Mayor, etc. of Memphis*, 7 Humph. (Tenn.) 553; *Miners' Ditch Co. v. Zellerbach*, 37 Cal. 543; 99 Am. Dec. 300; *Underhill v. Santa Barbara, etc. Co.*, 93 Cal. 300, 314; 28 Pac. 1049;

mere fact that the minutes of the directors contain no entry authorizing the affixing of the seal is insufficient to overcome this presumption.¹

§ 491. **Statutes regulating Method of Execution of Deeds of Corporations.**—Statutory provisions as to the mode of execution of deeds by a corporation will generally be construed as directory merely and will therefore not exclude any method of execution that might have been valid at common law.² Thus, a statute providing that the president and two other members shall sign a corporation's deed of real estate does not invalidate a deed executed in any manner that was good at common law.³

Nelson v. Spence (Ga.), 58 S. E. 697 (deed signed by treasurer); *Graham v. Partee* (Ala.), 35 So. 1016; 139 Ala. 310; 101 Am. St. Rep. 32 (where the name of the corporation was not subscribed to the deed); *Quackenboss v. Globe, etc. Ins. Co.*, 177 N. Y. 71; 69 N. E. 223 (where the instrument was signed by the president and secretary); *Kirkpatrick v. Eastern Milling, etc. Co.* (1), 135 Fed. 144; *Degnan v. Thoroughman*, 88 Mo. App. 62 (semble); *Bullen v. Milwaukee Trading Co.*, 85 N. W. 115; 109 Wisc. 41; *Collier v. Doe ex dem. Alexander*, 38 So. 244; 142 Ala. 422; *Benedict v. Denton*, Walker Ch. (Mich.), 336; *Deepwater Council v. Renick* (W. Va.), 53 S. E. 552; *Watkins v. Glas* (Cal.), 89 Pac. 840; *Woodhill v. Sullivan*, 14 C. P. (Up. Can.) 265, 273; *Springer v. Bigford*, 55 Ill. App. 198; *McDonald v. Chisholm*, 131 Ill. 273; 23 N. E. 596; Wigmore on Evidence, § 2169.

But see *Backer v. United States Gas Fixture Co.*, 84 N. Y. Supp. 149 (where the instrument was signed by the company's treasurer); *Reed v. Fleming*, 102 Ill. App. 668.

Cf. *Koehler v. Black River, etc. Co.*, 2 Black 715 (where the presumption was overthrown by sus-

picious circumstances). For other cases where the presumption was rebutted, see *Bliss v. Kaweah, etc. Co.*, 65 Cal. 502; 4 Pac. 507; *Blood v. La Serena, etc. Co.*, 113 Cal. 221, 225-226; 41 Pac. 1017; 45 Pac. 252; *Cullman Fruit & Produce Ass'n*, 155 Fed. 372, 376 (headnote inadequate); *Gibson v. Goldthwaite*, 7 Ala. 281, 294; 42 Am. Dec. 592.

As to what constitutes the regular corporate seal within the meaning of this rule, see *Blood v. La Serena, etc. Co.*, 113 Cal. 221, 225; 41 Pac. 1017; 45 Pac. 252; *Raub v. Blairstown Creamery Ass'n*, 56 N. J. Law 262; 28 Atl. 384 (holding that the presumption does not apply where a common paper seal is attached although the instrument itself, signed by the president, purported to be under the corporate seal).

¹ *McKee v. Cunningham* (Cal.), 84 Pac. 260, 262 (headnote inadequate); *Bliss v. Harris* (Colo.), 87 Pac. 1076.

² Cf. *supra*, § 476, and *infra*, § 1070, § 1475. See also *Bliss v. Harris* (Colo.), 87 Pac. 1076.

³ *Bason v. King's Mountain Mining Co.*, 90 N. Car. 417.

But see *Allen v. Brown*, 6 Kans.

Where a statute requires certain instruments to be signed or subscribed, it is not necessary that the corporate name be subscribed, but the signature of the officer in his official capacity is sufficient.¹

§ 492. **Acknowledgment of Deeds of Corporations.** — Statutes providing for the acknowledgment of deeds usually contain explicit directions as to the acknowledgment of deeds of corporations. Such express directions ought, as a matter of prudence, always to be followed; but probably they would not vitiate any acknowledgment that would have been good if no such provisions had been contained in the statute. At any rate, if the statute contain no express directions as to the mode of acknowledgment of deeds by corporations, the directors or officers who are authorized to affix the seal are also competent to acknowledge the deed.²

App. 704; 50 Pac. 505; *Isham v. Mill Ass'n*, 6 Paige (N. Y.) 54; *Bennington Iron Co.*, 19 Vt. 230. *Bowers v. Hechtman*, 45 Minn. 238,

¹ *Ismon v. Loder* (Mich.), 97 N. 241-242; 47 N. W. 792; *Kelly v. Calhoun*, 95 U. S. 710; *Merrill v.*

² *Gordon v. Preston*, 1 Watts (Pa.) 385 (headnote inadequate); 26 Am. Dec. 75; *Hopper v. Lovejoy*, 21 Atl. 298; 47 N. J. Eq. 573; 12 L. R. A. 588; *Lovett v. Steam Saw*

CHAPTER X

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§ 493. **Nominal or Share Capital distinguished from Borrowed Capital.** — We have seen above that general laws for the formation of joint-stock business corporations always, or almost always, provide that each company's incorporation paper shall state the amount — that is, the nominal amount — of the authorized capital, and the number of shares into which it shall be divided.¹ Theoretically, the full amount of this capital at its par value is always to be obtained by the company from subscriptions to its shares in money or money's worth; and with the funds so obtained the company is to carry on its business. In practice, as every one knows, a large part of many a company's nominal share capital represents no substantial assets, but mere "water," the actual working capital of the corporation being derived from the issue of bonds. But this practice, even if not illegal, is nevertheless not such as the law contemplates, and is therefore not reflected in its nomenclature.

§ 494-§ 498. *Nomenclature.*

§ 494. **"Capital Stock," "Stock" and "Stockholder," "Shares" and "Shareholder."** — The aggregate of the shares of capital is called the company's capital stock; and every share in this capital stock may itself, properly enough, be called stock, and its holder a stockholder. Accordingly, this terminology is prevalent in America, where no distinction is drawn between shares and stock,² or between a shareholder and a stockholder. As we have just intimated, this usage is entirely proper on etymological and historical grounds. In England, however, within the last

¹ *Supra*, § 109.

² *Harvard College v. Amory*, 9 Pick. (Mass.) 446, 461-462 ("There can be no doubt but that shares in manufacturing and insuring incorporations are and were commonly called and known by the name of

stock"); *Lockwood v. Town of Weston*, 61 Conn. 211; 23 Atl. 9 (holding that shares are taxable under a statute levying a tax upon all "stocks not issued by the United States").

fifty or sixty years, a popular practice has sprung up which distinguishes between shares and stock, the former term, "shares," being used to denote the indivisible shares which compose the capital of most business corporations while "stock" is used to designate a form of security which is infinitely subdivisible, or which is, at any rate, not divided into definite, indivisible shares. For instance, a company whose capital is composed of indivisible shares of the nominal amount of, say, one pound and is not transferable in fractions thereof, may "consolidate" its shares into "stock" which may be subdivided indefinitely and transferred in amounts of, say, ten shillings, five shillings, or one shilling, or even less. Necessarily, however, this "consolidation into stock" cannot well take place unless the shares are fully paid up; and some English judges have, therefore, said that shares and stock "differ in this respect that shares are not necessarily paid up."¹

§ 495. **Further Consideration of English Distinction between Shares and Stock.** — This distinction between shares and stock, although important to bear in mind in reading the English books is, even in England, a popular rather than a legal differentiation of terms. Thus, where a testator bequeathed to his wife "all such stocks in the public funds, or shares in any railway," of which he might die possessed, the House of Lords held that shares in a railway company which before the testator's death were consolidated into "stock" would nevertheless pass by the bequest.² Lord Selborne said:³ "The share, while still indivisible (whether subject to calls or paid up) and registered upon one plan of bookkeeping, is in substance and in truth nothing but a 'share in the capital stock of the company' and it is still a 'share in the capital stock of the company' after it has

¹ *Morrice v. Aylmer*, L. R. 7 H. L. De G. & Sm. 278 ("stock" in a statute held to include shares); 717, 724, per Lord Hatherley.

² *Morrice v. Aylmer*, L. R. 7 H. L. *Oakes v. Oakes*, 9 Hare 666 (holding that a bequest of all the G. W. Ry. shares of which testator might be possessed at the time of his death is not adeemed by conversion into stock of the shares owned by the testator at the date of the will but 717. does not pass other stock in the same company which he acquired afterwards).

Cf. *Re Bodman* (1891), 3 Ch. 135; *New Zealand Trust & Loan Co.* (1893), 1 Ch. 403 ("stock" in a statute held to include shares not fully paid up); *Trinder v. Trinder*, 1 Eq. 695 (bequest of "my shares in the G. W. Ry. Co." held to pass stock in that company, the testatrix owning no shares); *Re Angelo*, 5 L. R. 7 H. L. 729.

become divisible and registered upon a different system of book-keeping. . . . The difference makes no real change for any purpose whatever material to the nature or incidents of the property, except that the shareholders' power of transfer is no longer subject to certain restrictions."

§ 496. **Meaning of Stock in America.** — In the United States, the familiar use of the term "stockholders" to designate the owners of shares in the capital of a corporation not unnaturally leads to the notion that the word "stock" *ex vi termini* indicates that its holders are members and not creditors of the company.¹ Such, however, is not the case. For instance, every one is acquainted with "city stock," "United States stock," and other public stocks,² the holders of which are creditors of the government or municipality that issues the security. So, in England, business corporations frequently issue as evidence of indebtedness a form of security known as "debenture stock" — that is to say, certificates of indebtedness transferable on the company's books in fractional amounts.³ The fact that the stockholders of an ordinary American corporation are part owners of the company's capital and not creditors of the corporation should not, therefore, induce the belief that the term is especially appropriate for members of the company and inappropriate for its creditors. The holders of common or of preferred stock are not creditors but members of the corporation; but this is because of the real nature of their position, and could not safely be inferred merely from their designation as stockholders.

§ 497. **Whether "Capital" or "Capital Stock" refers to Nominal or to Actual Capital.** — Whenever the "capital" or the "capital stock" of a corporation is referred to, a question may arise whether the reference is to the nominal capital or to the actual capital of the company.⁴ The answer to this question

¹ See *State ex rel. Thompson v. stocks and shares in private corporations* *Cheraw, etc. R. R. Co.*, 16 S. Car. 524; *Hamlin v. Toledo, etc. R. R. Co.*, 78

Fed. 664, 670; 24 C. C. A. 271; 36 L. R. A. 826 (where the court said "Stock is capital").

Cf. *Sellar v. Charles Bright & Co.* (1904), 2 K. B. 446.

² Cf. *Lockwood v. Town of Weston*, 61 Conn. 211, 216, 23 Atl. 9 ("The word 'stock' includes both public

³ See *infra*, § 1687.

⁴ "The term 'capital stock' has a double meaning as applied to corporations. In one sense it is the sum mentioned in the articles of incorporation as the amount of the capital stock; in other words it is the share capital, or nominal capital, and does not necessarily represent a corre-

must depend in each instance on the context. For instance, "capital stock" in a statute forbidding corporations to divide, withdraw, or in any way pay to the stockholders any portion of the "capital stock," has been held to refer to the actual capital or assets of the corporation,¹ and not to the nominal or share capital, and therefore does not prohibit a stock dividend.² The amount of "actual capital paid in cash or property," has been construed to refer to the actual value of the company's property for the time being and not to the amount credited as paid up on the nominal capital, or to the amount of the property or money received in payment of the shares at its value when so received.³

§ 498. **Meaning of "Corporators."** — The term "corporators" is properly used to designate the persons who form and compose the corporation whether they be shareholders or not; and hence should not ordinarily be construed to include those who afterwards become members of the corporation.⁴ But the context may show that any shareholders or members of the corporation were intended to be comprised within the term.⁵

sponding amount of actual capital. . . . The capital stock referred to in the statute, however, is the actual property of the corporation": *Excelsior Water, etc. Co. v. Pierce*, 90 Cal. 131, 140; 27 Pac. 44. But cf. *People v. Commrs. of Taxes*, 23 N. Y. 192, 219 (where a dissenting judge, whose opinion is more to be relied upon than that of the majority, as the decision was reversed on error in 2 Black. 620, 635, declared that the word "capital" is unambiguous and refers only to actual capital, but that "stock" is ambiguous and may refer either to nominal or actual capital).

¹ *Martin v. Zellerbach*, 38 Cal. 300, 308-309; 99 Am. Dec. 365; *Excelsior Water, etc. Co. v. Pierce*, 90 Cal. 131, 140; 27 Pac. 44.

Cf. *State v. Morristown Fire Ass'n*, 23 N. J. Law 195; *People ex rel. Union Trust Co. v. Coleman*, 126

N. Y. 433; 27 N. E. 818; 12 L. R. A. 762 (as to the meaning of a company's "capital stock" for purposes of taxation).

² *Williams v. Western Union Tel. Co.*, 93 N. Y. 162.

³ *Person & Riegel Co. v. Lipps* (Pa.), 67 Atl. 1081.

⁴ *Chase v. Lord*, 77 N. Y. 1.

⁵ *Gulliver v. Roelle*, 100 Ill. 141 (followed in *Shufeldt v. Carver*, 8 Ill. App. 545); *Atlantic Mut. Life Ins. Co.*, 2 Fed. Cas. 168 (policy-holders in semi-mutual life insurance company held to be "corporators" entitled to notice of meeting called to authorize bankruptcy proceedings under U. S. Rev. Stats., § 5122, the Bankrupt Act of 1867); *Lady Bryan Mining Co.*, 14 Fed. Cas. 926; 1 Sawy. 349; 2 Abb. (U. S.) 527 (stockholders held to be "corporators" within last mentioned statute).

§ 499—§ 506. NATURE OF SHARES.

§ 499—§ 501. *Distinction between one Share and another Share of same Kind.*

§ 499. **Rule in England — Numbering of Shares.** — The capital stock of almost all American joint-stock corporations¹ and of the vast majority of English limited companies is divided into shares. In England, the practice is to give a separate denoting number to each share; and this practice is in many respects advantageous and worthy of imitation in the United States. In the first place, it affords an additional check against fraudulent overissues of shares. Moreover, it enables the title to particular shares to be traced through successive owners. Even, however, where the practice of numbering the shares prevails, the numbers are regarded as a mere convenience, and in no way affect the substantive rights of the holder.² One share is just the same as another share of the same kind, and a misstatement of the denoting numbers will not relieve a transferee of shares from liability thereon.³ Moreover, the renumbering of shares does not affect their identity. Hence, where a person holds shares bearing certain numbers, a surrender of his share-certificate to the company, followed by an issue of shares bearing the same numbers to some one else, does not necessarily amount to a transfer of the former shares, or release the original holder from liability as a shareholder;⁴ the new shares although bearing the same numbers as the old are in law and in fact different shares.

§ 500. **Rule in America.** — Moreover, where, as in America, shares are not distinguished by denoting numbers, so that one share is to all appearances the same as any other share, yet the individuality, so to speak, of the several shares is in law unaffected by this similarity. For instance, a pledgee of shares is ordinarily bound to keep the identical shares pledged to him,

¹ Cf. *Hawes v. Anglo-Saxon Petroleum Co.*, 101 Mass. 385 (declaring that where the incorporation paper fixes the amount of the capital stock but does not divide it into shares, the several subscribers become "tenants in common" of the stock).

² In addition to cases cited below, see *Adams' Case*, 13 Eq. 474, 483; *National Ins. Co. v. Egleson*, 21 Grant (Can.) 406.

³ *Ind's Case*, 7 Ch. 485.

⁴ *Ex parte Jones*, 27 L. J. Ch. 666.

and does not discharge his obligations to the pledgor by holding himself ready to surrender to the pledgor on payment of the debt other shares of the same value in the same company.¹ To be sure, if the pledged shares were originally mingled indiscriminately with other shares standing in the pledgee's name or if, by the custom of brokers or otherwise, the creditor is authorized to mingle the hypothecated shares with other shares in the same company, the pledgee is not bound to keep any particular shares to answer the debtor's claim but does his full duty if he always has in readiness a sufficient number of other shares to satisfy a demand for redemption by the hypothecator.² This, however, is not because the several shares have no legal individuality but because the confusion was expressly or impliedly authorized by contract; and consequently the result would have been the same if the company had followed the English practice of designating the several shares by distinguishing numbers.

§ 501. *Authorities maintaining that Shares are legally indistinguishable from one another.* — A few cases, however, cannot be thus explained, but must stand squarely upon the proposition that the several shares of the same issue are in law indistinguishable from one another. Thus, where a purchaser of shares was entitled to rescind the purchase on account of fraudulent misrepresentations of the vendor, it was held that this right of rescission could be exercised although he had parted with, and was consequently unable to return, the particular shares purchased, inasmuch as he had tendered other shares in the same company of the same value.³ Dicta in other cases lend

¹ *Fay v. Gray*, 124 Mass. 500; 198, 218; 26 Atl. 874; 28 Atl. 104; *Allen v. Dubois*, 117 Mich. 115; 75 21 L. R. A. 102; *Price v. Gover*, 40 N. W. 443; 72 Am. St. Rep. 557; Md. 102, 110-114; *Hubbell v. Drexel*, *Dykers v. Allen*, 7 Hill (N. Y.) 497; 11 Fed. 115; *Gilpin v. Howell*, 5 Pa. 42 Am. Dec. 87. St. 41, 56-58; 45 Am. Dec. 720;

But see *Hubbell v. Drexel*, 11 Fed. 115. Cf. *Atkins v. Gamble*, 42 Cal. 86; 10 Am. Rep. 282 (where nominal damages only were allowed for the technical conversion); *Bell v. Bank of Cal.* (Cal.), 94 Pac. 889. *Boylan v. Huguet*, 8 Nev. 345; *Smith v. Becker* (Wisc.), 109 N. W. 131 (holding that sale of some shares out of the mingled mass not conclusively presumed to be a sale of pledgee's own shares where sale of the pledged shares was clearly intended).

² *Nourse v. Prime*, 4 Johns. Ch. (N. Y.) 490; 8 Am. Dec. 606; 7 Johns. Ch. 69; 11 Am. Dec. 403; *Horton v. Morgan*, 19 N. Y. 170; 75 Am. Dec. 311; *Skiff v. Stoddard*, 63 Conn. Cf. *Worthington v. Tormey*, 34 Md. 182. ³ *Mayo v. Knowlton*, 134 N. Y.

color to the same proposition that the several shares of the capital stock of an American company are legally indistinguishable from one another.¹ Nevertheless, it is submitted that, as already intimated, the proposition is not supported by the best authorities and is contrary to sound principle. It may be that no special value attaches to a particular share-certificate and that a bailee of shares does not commit a conversion by surrendering the share-certificate and receiving a new certificate or certificates for the same shares. But although the identity of the certificate may be immaterial, the identity of the shares is important. For instance, the owner might be satisfied with the title to his own shares and therefore be unwilling to accept other shares in lieu thereof. That the title to the other shares may be in fact unimpeachable is no answer to the argument; for a property owner cannot be required to accept instead of his own property other property of the same kind equally valuable and held by a title equally sound. The true doctrine would seem to be that the similarity of one share to another will often justify the inference that the parties did not intend to insist on a return of the particular shares but would be satisfied with a return of the same number of other shares of the same issue and value;² but that unless such inference is possible, the several shares must be treated as, in law, quite as distinct from one another as, say, one bag of corn is from another bag of corn.

§ 502. A Share not an Interest legal or equitable in Company's Property — Whether Real or Personal Estate, etc. — A share of capital stock is property of a peculiar kind. It does not consist in an interest either legal or equitable, direct or indirect, in the property of the company.³ To be sure, many lawyers

250; 31 N. E. 985; *American Alkali Co. v. Salom*, 131 Fed. 46, 49-50; 65 C. C. A. 284.

Note that these cases may be supported, perhaps, upon the ground that the defrauded party should be allowed to rescind the contract upon restoration of *substantially*, if not *technically*, the original status.

¹ See cases cited *supra*, p. 418, n. 2. Cf. *Atkins v. Gamble*, 42 Cal. 86; 10 Am. Rep. 282.

² *Dykers v. Allen*, 7 Hill (N. Y.) 497; 42 Am. Dec. 87 (semble, per Walworth, C., as to construing a loan of shares as a *mutuum*).

³ *Regina v. Arnaud*, 9 Q. B. 806; *Commonwealth v. New York, etc. R.*

and judges are accustomed to say that the shareholders are in equity the owners of the corporate property; but every one recognizes that such expressions are in legal theory inaccurate. For example, a share of capital stock is personalty although the corporation may own real estate.¹ Even a statute expressly declaring that shares shall be deemed real estate has been construed to make the shares realty only for the purpose of being inheritable, leaving them for all other purposes personal property as at common law.² So, a sale of shares cannot be deemed a sale of an interest in the goodwill of the company within the meaning of a statute which forbids any agreement to refrain from exercising a lawful trade or business except by a seller of goodwill; and consequently, under such a statute a shareholder whose personality is closely associated with the goodwill of the company's business cannot, upon selling his interest in the corporation, agree with the purchaser to refrain

Co., 132 Pa. St. 591; 19 Atl. 291; 7 L. R. A. 634 (stated *infra*, § 1080).

¹ *Russell v. Temple*, 3 Dane's Abridgment (Mass.) 108; *Bligh v. Brent*, 2 Y. & C. Ex. 268; *Bradley v. Holdsworth*, 3 M. & W. 422; *Elkhorn Land, etc. Co. v. Childers* (Ky.) 100 S. W. 222; *Chappell v. Chappell* (Ky.), 99 S. W. 959, 960 (headnote inadequate — distinguishing *Price v. Price*, 6 Dana (Ky.) 107, and *Copeland v. Copeland*, 7 Bush. (Ky.) 349, in which cases stock in railway companies was held real estate, as governed by peculiar statutes); *Johns v. Johns*, 1 Ohio St. 350; *Mattingly v. Roach*, 84 Cal. 207; *South-Western R. R. Co. v. Thomason*, 40 Ga. 408; *Arnold v. Ruggles*, 1 R. I. 165; *McKeen v. County of Northampton*, 49 Pa. St. 519; 88 Am. Dec. 515 (for purposes of taxation).

The same has been held in England in respect to shares in an unincorporated joint-stock company formed upon the "cost-book" principle, *Watson v. Spratley*, 10 Ex. 222 (as to the nature of a cost-book company or partnership, see 1 Lindley on Companies, 6th ed., p. 132); and in respect to shares in other purely

voluntary associations, *Watson v. Black*, 16 Q. B. D. 270 (shareholder not qualified to vote as equitable freeholder although land is held by trustees in trust for the association); and in Connecticut in respect to shares in an unincorporated joint-stock company such as the Adams Express Company: *Lockwood v. Town of Weston*, 61 Conn. 211; 23 Atl. 9.

See also article by Prof. Williston in 2 Harv. L. Rev. 149, 150-151, where the learned author, reviewing the early cases, shows that prior to the nineteenth century a share of capital stock was regarded as an equitable interest in the property of the corporation and therefore as real or personal estate according to the nature of the property.

In *Saup v. Morgan & Co.*, 108 Ill. 326, 329, a tax levied on the capital stock of a corporation — not the shares of stock — was held to be a personal tax.

² *Cooper v. Dismal Swamp Canal Co.*, 6 N. Car. 195.

Cf. *Cape Sable Company's Case*, 3 Bland Ch. (Md.) 606.

from engaging in the same business in competition with the corporation.¹ On the other hand, a shareholder has an insurable interest in the property of the company;² for he has in fact, although not perhaps technically or in law, a financial interest in the property which is sufficient to prevent the policy from being a mere wager.

§ 503. **A Share not a Sum of Money settled in Trust but an Interest in the Company.** — On the other hand, a share cannot be properly deemed a sum of money³ — the amount paid in or contributed by the subscriber — settled or invested upon a trust. This was decided in a recent English case in which the true nature of a share of capital stock was very clearly stated by the court. Said Farwell, J.: “A share, according to the plaintiff’s argument, is a sum of money which is dealt with in a particular manner by what are called for the purpose of argument executory limitations. To my mind it is nothing of the sort. A share is the interest of a shareholder in the company measured by a sum of money, for the purpose of liability in the first place, and of interest in the second, but also consisting of a series of mutual covenants entered into by all the shareholders *inter se* in accordance with § 16 of the Companies Act, 1862. The contract contained in the articles of association is one of the original incidents of the share. A share is not a sum of money settled in the way suggested, but is an interest measured by a sum of money and made up of various rights contained in the contract, including the right to a sum of money of a more or less amount.”⁴

§ 504. **A Share as a Chose in Action.** — Hence, it follows that a share in an incorporated company is personal property of the kind known as choses in action.⁵ For example, shares in a cor-

¹ *Merchants’ Ad. Sign Co. v. Sterling*, 124 Cal. 429; 57 Pac. 468; 71 Am. St. Rep. 94; 46 L. R. A. 142.

² *Warren v. Davenport Fire Ins. Co.*, 31 Iowa 464; 7 Am. Rep. 160.

³ Cf. *Jones v. Brinley*, 1 East 1 (relating, doubtless, to government stock); *Nightingal v. Devisme*, 5 Burr. 2589 (relating to East India stock); *Bridgman v. City of Keokuk*, 72 Iowa 42; 33 N. W. 355 (shares not moneys or credits); *Gosden v. Dotterill*, 1 Myl. & K. 56 (holding

that consols or public stocks will not pass under a bequest of “money”).

⁴ *Borland’s Trustee v. Steel Bros. & Co.* (1901), 1 Ch. 279, 288.

The definition of a share, given in *Nanney v. Morgan*, 37 Ch. D. 346, 352, 356, as the right to vote and to receive dividends is submitted to be incorrect. There are other rights involved in the ownership of a share besides those mentioned. Moreover, a person may be a shareholder without the right to vote.

⁵ *Webb v. Baltimore, etc. R. R. Co.*,

poration are "things in action" within the meaning of the English bankrupt act.¹ So, too, they have been held to be "choses in action" within the meaning of an attachment law, the company being properly made garnishee.² Moreover, it has been held that shares are choses in action within the meaning of the federal statute which restricts the right of an assignee of a chose in action to invoke the jurisdiction of the federal courts on the ground of diverse citizenship to cases in which the same diversity of citizenship would have existed if the assignor had been the plaintiff;³ but this decision must have been but poorly considered, inasmuch as in hundreds of cases shareholders who derive title by assignment from the original subscribers have maintained shareholders' bills in the federal courts on the ground of diversity of citizenship.⁴

§ 505. **Whether Shares are "Goods, Wares or Merchandise," "Personal Chattels," "Goods and Chattels," "Securities," etc.** — According to the better view, shares are not *goods, wares, or merchandise*, within the Seventeenth Section of the Statute of Frauds.⁵

77 Md. 92; 26 Atl. 113; 39 Am. St. Rep. 396; *Johnson v. Hume*, 138 Ala. 564; 36 So. 421 (as to the common law rights of the husband on reducing shares of his wife to possession); *Arnold v. Ruggles*, 1 R. I. 165 (as to the marital rights of the husband at common law); *Slaymaker v. Bank of Gettysburg*, 10 Pa. St. 373.

But see *Ramsey v. Gould*, 57 Barb. (N. Y.) 398 (holding that shares are not within a statute prohibiting attorneys from buying any bond or other "thing in action" for the purpose of bringing suit thereon).

¹ *Colonial Bank v. Whinney*, 11 App. Cas. 426.

² *Lipscomb v. Condon*, 56 W. Va. 416; 49 S. E. 392; 107 Am. St. Rep. 938; 67 L. R. A. 670. As to the soundness of this decision, *quære*.

³ *Gorman-Wright Co. v. Wright*, 134 Fed. 363; 67 C. C. A. 345.

⁴ Cf. Rule 94 of the Supreme Court, restricting this right. See *infra*, § 1170.

⁵ *Duncuft v. Albrecht*, 12 Sim. 189; *Bowlby v. Bell*, 3 C. B. 284;

Vawter v. Griffin, 40 Ind. 593 (semble, under a statute which omitted the words "wares or merchandise"); *Webb v. Baltimore, etc. R. R. Co.*, 77 Md. 92; 26 Atl. 113; 39 Am. St. Rep. 396 (distinguishing *Colvin v. Williams*, 3 H. & J. (Md.) 38); *Browne* on Stat. of Frauds, 5th ed., § 296-§ 298.

Contra: *Hightower v. Ansley* (Ga.), 54 S. E. 939 (overruling *Rogers v. Burr*, 105 Ga. 432; 31 S. E. 438; 70 Am. St. Rep. 50); *Fine v. Hornsby*, 2 Mo. App. 61, 64; *Pray v. Mitchell*, 60 Me. 430, 434-435 (shares in an unincorporated company); *Tinsdale v. Harris*, 20 Pick. (Mass.) 9; *Boardman v. Cutter*, 128 Mass. 388; *North v. Forest*, 15 Conn. 400; *Baltzen v. Nicolay*, 53 N. Y. 467 (where the point although necessarily involved and decided was not argued or mentioned in the opinion of the court).

For an analysis of the phraseology of the statutes of frauds of the several American states, together with a discussion of their application to contracts for sale of shares, see 2 Dos

They are, however, *personal chattels*; ¹ for that expression includes every kind of personal property except chattels real. So, they are "*goods and chattels*" within the meaning of the statute of 13 Eliz., c. 5, as to conveyances in fraud of creditors,² and the price of shares may be recovered under a count for "*goods and chattels*" sold and delivered.³ On the other hand they are not "*goods and chattels*" within the Factors Acts.⁴ Of course, shares are included under the designation "*personal property*,"⁵ unless the context shows that only tangible property is meant. Although the word "*securities*" properly and primarily designates "*money secured on property*,"⁶ in which sense it would

Passos on Stockbrokers and Stock Exchanges, 2d ed., 883 et seq.

The English rule applies to contracts for sale of shares in an unincorporated company formed upon the joint-stock principle which therefore are not within the Seventeenth Section of the Statute of Frauds: *Watson v. Spratley*, 10 Ex. 222.

So, scrip in a railway company is not "*goods, wares, and merchandise*" within the English Stamp Acts: *Knight v. Barber*, 16 M. & W. 66.

On the other hand, even in England, it has been held that a Rule of Court authorizing a sale of "*goods, wares, and merchandise*" applies to shares: *Evans v. Davies* (1893), 2 Ch. 216.

¹ *Colonial Bank v. Whinney*, 11 App. Cas. 426, 434 (per Lord Blackburn).

² *Pinkerton v. Manchester, etc. R. R. Co.*, 42 N. H. 424, 451. Cf. *Robinson v. Jenkins*, 24 Q. B. D. 275 (Rule of Court allowing interpleader proceedings where a party is under liability for any "*debt, money, goods or chattels*," held to apply to shares on account of the generality of the word "*chattels*").

³ *Lawton v. Hickman*, 9 Q. B. 563.

⁴ *Freeman v. Appleyard*, 32 L. J. Ex. 175 (cited without disapproval in *Williams v. Colonial Bank*, 38 Ch. D. 388, 408).

Cf. *First Nat. Bank v. Holland*, 99 Va. 495; 39 S. E. 126; 86 Am. St.

Rep. 898; 55 L. R. A. 155 (holding that shares are not within a statute requiring certain formalities in cases of gifts of "*goods and chattels*"); *Rex v. Capper*, 5 Price 217 (holding that stock in the public funds will not pass under a royal grant of *bona et catalla felonum*); *Williamson v. New Jersey Southern R. R. Co.*, 26 N. J. Eq. 398 (holding that shares are not "*goods and chattels*" within a statute requiring registration, etc. of chattel mortgages); *Morton v. Cowan*, 25 Ont. 529 (shares not within a statute as to execution upon interests in "*goods and chattels*").

⁵ *Jellinik v. Huron Copper Mining Co.*, 177 U. S. 1; 20 Sup. Ct. 559; *Mattingly v. Roach*, 84 Cal. 207 (holding mining shares to be within a statute regulating the place of delivery in sales of personal property); *Attorney-General v. Montefiore*, 21 Q. B. D. 461 (shares within a statute levying a tax on a "*disposition of property*" to take effect after death); *Desinge v. Beare*, 37 Ch. D. 481 (bequest of "*my property at R's bank*" held to pass shares in French companies represented by certificates at R's bank at which locality the testator had no tangible property).

⁶ Cf. *Duncan v. Maryland Sav. Inst.*, 10 G. & J. (Md.) 299, 308 (where in construing a statutory power to invest in "*public stocks or other securities*," the word "*secur-*

not include shares and stocks in incorporated companies,¹ yet the word has acquired the wider popular significance of "investments" — a sense which is broad enough to include stocks and shares.² Shares are not comprised within the term "money" or "moneys."³ Although shares are choses in action, yet they are not "credits."⁴

§ 506. **Whether Trover will lie for Conversion of Shares.** — A share of capital stock being a chose in action, or intangible property, an action of trover, properly so called, will not lie for its conversion.⁵ But an action on the case in the nature of trover may be maintained.⁶ Moreover, trover will lie for a conversion of the share-certificate⁷ just as it will lie for conversion of a promissory note, bill of lading, or other security.

§ 507. **Nominal or share Capital not a Liability of Company.** — The share capital of a corporation is in no proper sense a liability" was said to mean "anything given or deposited to secure the payment of a debt").

¹ *Thayer v. Wathen* (Tex.), 44 S. W. 906; 17 Tex. Civ. App. 382; *Bartholomay Brewing Co. v. Wyatt*, (1893), 2 Q. B. 499, 516 ("Shares in a company are not securities but portions of its capital"); *Mechanics' Bank v. New York, etc. R. R. Co.*, 13 N. Y. 599, 627 ("Certificates of stock are not securities for money in any sense"); *Ogle v. Knipe*, 8 Eq. 434 (bank stock and canal shares not covered by a bequest of "all my money and securities for money"); *Graydon's Exrs. v. Graydon*, 23 N. J. Eq. 229 (direction in will to convert into money all personal estate not already in money or securities held to require conversion of shares owned by testator); *Bank of Commerce v. Hart*, 37 Nebr. 197, 203 (headnote inadequate); 55 N. W. 631; 20 L. R. A. 780; 40 Am. St. Rep. 479 (power in charter of bank to "purchase securities of every kind," held not to authorize purchase of shares of stock in other corporations); *Huddleston v. Gouldsbury*, 10 Beav.

547 (holding that canal shares will not pass under a bequest of property vested in "bonds or securities").

² *Rayner v. Rayner* (1904), 1 Ch. 176.

³ *Collins v. Collins*, 12 Eq. 455; *Ogle v. Knipe*, 8 Eq. 434; and supra, § 503.

But see *Knight v. Knight*, 2 Giff. 616 (where Malins, V. C., held that a bequest of "all sums and sums of money that might be in the house," would pass shares represented by certificates enclosed in an envelope and endorsed by the testator "to be considered as ready money"; but *quære* whether the learned judge was right in considering such extrinsic evidence of the testator's intent).

⁴ *Bridgman v. City of Keokuk*, 72 Iowa 42; 33 N. W. 355.

⁵ *Sewall v. Lancaster Bank*, 17 S. & R. (Pa.) 285.

⁶ See cases collected infra, § 932, § 934, § 937, § 940, and also § 515.

Cf. *Ashton v. Heydenfelt*, 124 Cal. 14; 56 Pac. 624.

⁷ *Sewall v. Lancaster Bank*, 17 S. & R. (Pa.) 285, 287 (semble); *Brown v. Bokee*, 53 Md. 155, 170.

bility of the company. To be sure, accountants often include a company's capital stock among its liabilities; but this practice is a mere convenient bookkeeping device, and in no way represents or accords with a correct legal use of the term.¹ Thus, a share in a corporation cannot be treated as a liability owing from the company to the shareholder and capable of being set off against a debt due from the shareholder to the company, so as virtually to give the company a lien on the shares in case the holder becomes bankrupt.² So, the capital should not be reckoned as a liability in determining whether the company is solvent or insolvent.³

§ 508—§ 516. RIGHTS OF SHAREHOLDERS.

§ 508. **Primary or substantive Rights — Classification.** — The shareholders in a corporation constituting the company and a share being an interest in the corporation, the rights incident to the ownership of shares are rights which flow from the ownership of an interest in, or part of, the corporation. By a broad classification, these rights, so far as they are primary or substantive in character, may be reduced to four, namely, (1) the right to participate in profits earned by the company, or, in other words, the right to dividends, (2) the right to share in any assets which may remain upon the dissolution of the corporation after the creditors shall have been paid, (3) the right to participate in actual capital which is left free by a reduction of nominal capital and (4) the right to participate in the management of the company, or, in other words, to vote at shareholders' meetings. To these may, perhaps, be added the preemptive right to subscribe to any increase of capital before the new shares are issued to strangers.⁴

¹ But see *Posner v. Southern Exhaust, etc. Co.*, 109 La. 658, 666; 33 So. 641 ("A corporation owes and does not own the stock").

Cf. *Gansey v. Orr*, 173 Mo. 532; 73 S. W. 477; *Miller v. Bradish*, 69 Iowa 278; 28 N. W. 594; *Eyster v. Centennial Board of Finance*, 94 U. S. 500, 502 ("The liability of a corporation to its stockholders on account

of their stock is not a debt," — per Waite, C. J.); *Heller v. Nat. Marine Bank*, 89 Md. 602, 611; 43 Atl. 800; 73 Am. St. Rep. 212; 45 L. R. A. 438.

² *Kingstown Yacht Club*, 21 L. R. Ir. 199.

³ *Shaw v. Gilbert*, 111 Wisc. 165, 178-179; 86 N. W. 188.

⁴ *Infra*, § 603 et seq.

§ 509. *References to full Discussions of these Primary Rights.* — The first of these rights, namely, the right to dividends, is the subject of special consideration below and in other parts of this work.¹ The second, or the right to participate in the distribution of capital upon dissolution of the company, belonging as it does to the topic of the winding-up and dissolution of corporations, is outside the scope of this treatise, and is therefore treated only incidentally.² The third, the right to participate in actual capital left free upon reduction of nominal capital, is fully considered under the heading of reduction of capital.³ The fourth, the right to vote at general meetings of the company, receives detailed consideration in the chapter on shareholders' meetings.⁴

§ 510–§ 516. SECONDARY OR ANCILLARY RIGHTS OF SHAREHOLDERS.

§ 510. *Classification of secondary or ancillary Rights.* — In addition to these several rights, or more properly as ancillary to them, each shareholder is entitled to demand that the company shall recognize his status as a member. This recognition is accorded in two ways, firstly, by enrolling his name in the company's register of members and, secondly, by issuing to him a share-certificate or solemn admission or representation by the company that the person in question is the owner of a certain specified number of shares. Another right of a shareholder of the same general class is the right to inspect books of the corporation.⁵

§ 511. *Right to Registration as Shareholder in Company's Books.* — The enrolment as a shareholder may be necessary to perfect the shareholder's title: at all events without enrolment his tenure is precarious and uncertain. If the company refuses to register him as shareholder, he may treat such refusal as a conversion of his shares and sue in tort for conversion,⁶ or he

¹ *Infra*, § 519, § 550–§ 563 and Chapter XXIII.

² *Infra*, § 520–§ 521; § 564–§ 568.

³ *Infra*, § 660–§ 668.

⁴ *Infra*, Chapter XXI.

⁵ As to this see *infra*, § 1094 et seq.

⁶ *Salt River Canal Co. v. Hickey*, 36 Pac. Rep. 171; 4 Ariz. 240.

Cf. *Cooley v. Curran*, 104 N. Y. Supp. 751 (holding that such an action cannot be maintained against the company's treasurer); *Nat. Bank of New London v. Lake Shore*,

may probably sue in assumpsit for damages sustained by the company's breach of its legal duty or quasi-contractual obligation.¹ Secondly, he may proceed by bill in equity,² or probably, if his title to the shares be clear, by mandamus³ to compel the company to recognize his title and register him as shareholder. An owner of an undivided interest in a share is entitled to have his right recognized by an entry on the company's books.⁴

§ 512-§ 516. *Right to a Share-Certificate.*

§ 512. **Definition of Certificate.** — A share-certificate is nothing more than a solemn affirmation, usually under the corporate seal,⁵ and signature of the appropriate officer or officers, that the person named therein is entitled to a specified number of shares.⁶ "A share-certificate," said Judge Thompson, "is a solemn and continuing affirmation by the corporation that the person to whom it was issued is entitled to all the rights and subject to all the liabilities of a stockholder in the company in respect of the number of shares named, and that the company will respect his rights and the rights of every one to whom he may transfer such shares [by refusing to admit any new transferee to the rights of a shareholder except upon surrendering of the certificate]." ⁷ The last clause destroys the accuracy of the definition; for it is certainly not an essential part of a share-certificate that the company should represent that no transfer will be recognized except upon its surrender: but if the words in brackets be omitted, the definition is correct.

§ 513. **Right to a Certificate, in general.** — The issue of a share-certificate is never necessary in order to perfect a share-

etc. Ry. Co., 21 Ohio St. 221 (holding that the action cannot be maintained by a mere equitable owner of shares).

¹ See *infra*, § 934.

² See *infra*, *ibid.*

³ See *infra*, *ibid.*

Cf. People ex rel. Doyle v. N. Y. Benevolent Soc., 3 Hun (N. Y.) 361; *Delacy v. Neuse Nav. Co.*, 1 Hawks (N. Car.) 274; 9 Am. Dec. 636.

⁴ *Salt River Canal Co. v. Hickey*, 36 Pac. Rep. 171; 4 Ariz. 240. *Cf. infra*, § 1007.

⁵ As to this see *Fitzhugh v. Bank of Shepherdsville*, 3 T. B. Monr. (Ky.) 126, 128; 16 Am. Dec. 90. *Cf. infra*, § 921.

⁶ See *Richardson v. Delaware Loan Co.*, 9 Houst. (Del.) 354; 32 Atl. 980 (where the instrument in question although not called a share-certificate would seem to have been such in legal effect).

⁷ *Keller v. Eureka, etc. Mfg. Co.*, 43 Mo. App. 84, 87-88; 11 L. R. A. 472.

holder's title. He is as much a shareholder before the issue of the certificate as afterwards.¹ Nevertheless, every shareholder has a right to demand a share-certificate as a muniment of his title² — a right to have in his own possession some authoritative evidence of his title. Of course, a transferee of shares who has never presented his transfer for registration has no right to demand the issue of a share-certificate.³ The share-certificate should correspond with the register of shareholders, so that the company is not entitled to put any qualification in the certificate which it is not entitled to put in the registry.⁴ If the shareholder has not paid for his shares in full, of course he is not entitled to a certificate representing him to be a holder of paid-up shares;⁵ but he is entitled to a certificate stating that he is the holder of so many shares and mentioning the exact amount which has been paid in on each.⁶ Strange to say, this latter proposition seems to have been denied in several cases.⁷ It is doubtless true that a shareholder who is in default for non-payment of calls is not entitled to any certificate.⁸ If a person is the holder of a number of shares upon which a certain proportion has been paid, he has no right to demand that the whole amount paid be applied to certain of the shares so as to make them fully paid shares and entitle him to a certificate stating them to be so paid up.⁹

A federal judge has recently announced that a shareholder who owns twenty-five shares has no right to demand a separate certificate for each share, such a demand being thought to be

¹ *Supra*, § 171.

² *Burdett v. Standard Exploration Co.*, 16 Times L. R. 112.

³ *Lacaff v. Dutch Miller, etc. Co.*, 31 Wash. 566; 72 Pac. 112.

⁴ *W. Key & Son* (1902), 1 Ch. 467.

⁵ *Babcock v. Schuylkill, etc. R. R. Co.*, 133 N. Y. 420; 31 N. E. 30.

⁶ *Fletcher v. McGill*, 110 Ind. 395, 405; 10 N. E. 651; 11 N. E. 779 (semble); 1 Morawetz on Priv. Corps., 2d ed., § 472.

⁷ *California, etc. Hotel Co. v. Calender*, 94 Cal. 120; 29 Pac. 859; 28 Am. St. Rep. 99; *Mobile, etc. R. R. Co. v. Yandal*, 5 Sneed (Tenn.) 294, 296 (semble); *Fulgam v. Macon*,

etc. R. R. Co., 44 Ga. 597, 598 (semble).

Cf. *Green v. Abietine Medical Co.*, 96 Cal. 322, 329-330; 31 Pac. 100.

⁸ *Johnson v. Albany, etc. R. R. Co.*, 54 N. Y. 416; 13 Am. Rep. 607

(where the remedy against the shareholder for refusal to pay the portion of his subscription remaining unpaid had been barred by limitations); *Gould v. Town of Oneonta*, 71 N. Y. 298 (holding that shareholder is not entitled to the certificate until interest on overdue calls as well as the principal is paid).

⁹ *Johnson v. Albany, etc. R. R. Co.*, 54 N. Y. 416; 13 Am. Rep. 607.

unreasonable.¹ But for this expression of judicial opinion, one would have supposed that a shareholder might, if so minded, insist upon a separate certificate for each share or unit of the capital stock.

§ 514. **Delay in issuing Certificate.** — What is a reasonable time for the company to delay issuing a share-certificate must depend largely upon circumstances. Some allowance must be made, especially in the case of the first issue of shares, for the mere physical labor of preparing and printing or engraving the certificates. But the mere fact that considerable time must elapse before certificates can be issued to some of the subscribers does not justify the company in delaying the issue of certificates to other subscribers.² Now, by statute, in England a certificate must be issued within two months after allotment.³

§ 515. **Remedies for Refusal or improper Failure to issue Certificate.** — The right to a share-certificate, if denied by the company, may be enforced by mandamus⁴ or bill in equity.⁵ If the remedy in equity be resorted to by a shareholder who has paid for his shares in property instead of in cash, the bill need not aver the property so transferred to be equal in value to the shares for which it was to be exchanged.⁶ The statute of limitations does not begin to run against the right of a shareholder to compel the company to issue a certificate to him until a certificate has been demanded by the shareholder and refused by the company.⁷ The refusal may also, at least in most cases, be

¹ *Schell v. Alston Mfg. Co.*, 149 Fed. 439.

² *Burdett v. Standard Exploration Co.*, 16 Times L. R. 112.

³ Companies Act, 1907 (7 Edw. VII, c. 50), § 5 (1).

⁴ *Hair v. Burnell*, 106 Fed. 280 (where the writ was against the officers of the corporation); *State ex rel. Thompson v. Cheraw, etc. R. R. Co.*, 16 S. Car. 524; *State ex rel. Phillips v. New Orleans Gas Light Co.*, 25 La. Ann. 413.

But see *Baker v. Marshall*, 15 Minn. 177; *State ex rel. Elliot v. Guerrero*, 12 Nevada 105; *Townes v. Nicholls*, 73 Me. 515; *State v. Carpenter*, 51 Ohio St. 83; 37 N. E. 261; 46 Am. St. Rep. 556.

⁵ *Bedford v. American Aluminum Co.*, 51 N. Y. App. Div. 537; 64 N. Y. Supp. 856; *Davenport v. Plano Implement Co.*, 70 Ill. App. 161; *Kinnan v. Forty-second St., etc. Ry. Co.*, 140 N. Y. 183; 35 N. E. 498; *Wells v. Green Bay, etc. Co.*, 90 Wisc. 442; 64 N. W. 69 (directors held proper but not necessary parties defendant).

⁶ *Davenport v. Plano Implement Co.*, 70 Ill. App. 161.

⁷ *Wells v. Green Bay, etc. Co.*, 90 Wisc. 442; 64 N. W. 69; *Mercer County Court v. Springfield, etc. Turnpike Co.*, 10 Bush (Ky.) 254. As to what is sufficient demand, see *Teeple v. Hawkeye Co.* (Iowa), 114 N. W. 306.

treated as a conversion of the shares for which damages are recoverable;¹ or redress may be had in action of assumpsit against the company.² Undue delay in issuing a share-certificate will have the same effect as a peremptory refusal in enabling the shareholder to sue for damages or for relief by mandamus or in equity.³ The refusal to issue a certificate, if the shareholder elect to treat it as a conversion of the shares, relieves him from any subsequent liability as shareholder to the corporation, its receiver or liquidator,⁴ or to its creditors. The shareholder may also obtain an injunction against issuing a certificate for any of his shares to any person other than himself.⁵

§ 516. **Loss of Certificate.** — If the certificate is lost or destroyed, the shareholder may require the company to issue to him a duplicate.⁶ As a condition to this relief, it would seem that he should ordinarily be required to give a sufficient bond of indemnity against any liability of the company by estoppel upon the former certificate.⁷ Where the certificate had been lost and unheard of for twelve years, the issue of a duplicate was required

¹ *Withers v. Lafayette County Bank*, 67 Mo. App. 115; *Baltimore City Pass. Ry. Co. v. Sewell*, 35 Md. 239; 6 Am. Rep. 402.

Cf. *Burdett v. Standard Exploration Co.*, 16 Times L. R. 112.

² *Wyman v. American Powder Co.*, 8 Cush. (Mass.) 168.

³ *Burdett v. Standard Exploration Co.*, 16 Times L. R. 112.

⁴ *Potts v. Wallace*, 32 Fed. 272.

⁵ *Bedford v. American Aluminum Co.*, 51 N. Y. App. Div. 537; 54 N. Y. Supp. 856.

⁶ *Kinnan v. Forty-second St., etc. Ry. Co.*, 140 N. Y. 183; 35 N. E. 498.

But see *Keller v. Eureka, etc. Mfg. Co.*, 43 Mo. App. 84; 11 L. R. A. 472 (containing a strong dissenting opinion); *Dempster v. Rosehill Cemetery Co.*, 206 Ill. 261; 68 N. E. 1070 (where the remedy was held to be barred by laches).

As to statutory remedies in case of loss or destruction of certificates, see *Biglin v. Friendship Ass'n*, 46 Hun (N. Y.) 223; *Hendon v. North Carolina R. R. Co.*, 125 N. Car. 124;

34 S. E. 227; *Hendon v. North Carolina R. R. Co.*, 127 N. Car. 110; 37 S. E. 155 (holding that plaintiff need not tender a bond before bringing suit if his right to a certificate is denied); *Re Speir*, 69 N. Y. App. Div. 149; 74 N. Y. Supp. 555; *Re Hayt*, 39 N. Y. Misc. 356; 79 N. Y. Supp. 845 (remedy provided by a state statute held applicable to shares in a national bank); *Re Coats*, 75 N. Y. App. Div. 469; 78 N. Y. Supp. 425; *Travers v. North Carolina R. R. Co.*, 133 N. Car. 322; 45 S. E. 651 (provision for holding new certificate in escrow for a period of years held to be repealed by a statute requiring plaintiff to give security). As to transfers by a person who has lost his certificate, see *infra*, § 928.

⁷ *Galveston City Co. v. Sibley*, 56 Tex. 269; *State ex rel. McCay v. New Orleans Stock Exchange*, 114 La. 324; 38 So. 204.

Cf. *Kinnan v. Forty-second St., etc. Ry. Co.*, 140 N. Y. 183; 35 N. E. 498.

in Minnesota without insisting upon a bond of indemnity.¹ Inasmuch as the lapse of time in such a case is the basis of the plaintiff's title to relief, a judgment some years previous between the same parties denying the same relief has been held to be no bar.² In Louisiana, a corporation was compelled to issue a new certificate to take the place of one which had been lost without a bond of indemnity being given and without any proof, so far as the report discloses, of any great lapse of time after the loss;³ but this decision was placed upon the more than doubtful ground that a purchaser of the certificate could have no claim against the company,⁴ and has been expressly overruled.⁵ In a case where a bankrupt shareholder had absconded with the share-certificate, a federal court decreed that the company upon being tendered a sufficient bond of indemnity should execute another certificate to the assignee in bankruptcy.⁶

§ 517-§ 523. EQUALITY OF SHARES.

§ 517. **Origin and Nature of Rule of Equality.** — The rule of law is that *prima facie* all the shareholders stand on an equality. The courts have repeatedly declared that this *prima facie* equality among the shareholders is not derived by implication from the construction of the incorporation paper, which in the simple case states merely that the capital of the company shall be such and such an amount divided into so many shares, but is a corollary of the presumption of equality among partners.⁷

¹ *Guilford v. Western Union Tel. Co.*, 59 Minn. 332; 61 N. W. 324; 50 Am. St. Rep. 407 (depending in part upon a local statute). So. 174 (where ten years had elapsed since the loss).

⁴ See *infra*, § 909 et seq.

Cf. *Guilford v. Western Union Tel. Co.*, 43 Minn. 434; 46 N. W. 70. ⁵ *State ex rel. McCay v. New Orleans Stock Exchange*, 114 La. 324, 327; 38 So. 204.

² *Guilford v. Western Union Tel. Co.*, 59 Minn. 332; 61 N. W. 324; 50 Am. St. Rep. 407. ⁶ *Wilson v. Atlantic, etc. R. R. Co.*, 2 Fed. 459.

Cf. *Guilford v. Western Union Tel. Co.*, 43 Minn. 434; 46 N. W. 70. ⁷ *South Durham Brewery Co.*, 31 Ch. D. 261; *Guinness v. Land Corp.*, 22 Ch. D. 349, 377 (semble); *Andrews v. Gas Meter Co.* (1897), 1 Ch. 361.

³ *State ex rel. Phillips v. New Orleans Gas Light Co.*, 25 La. Ann. 413.

Cf. *State ex rel. Benedict v. Southern Mineral, etc. Co.*, 108 La. 24; 32 Dr. & Sm. 521 (overruled). But see *Hutton v. Scarborough Hotel Co.*, 2 Dr. & Sm. 521 (overruled).

The true meaning of this pronouncement is that the equality among the shareholders is not part of the company's unalterable constitution but is, like the presumption of equality among partners, a mere private matter for the shareholders concerned. Any alteration in this *prima facie* equality involves the creation of preferential rights, and will be considered below. The subject that now presses for attention is the legal idea of equality among shareholders — what the law means by equality.

§ 518–§ 521. *WHAT THE LAW MEANS BY EQUALITY BETWEEN SHARES.*

§ 518. **Where Shares are of Different Nominal or Par Values.** — Commonly, all the shares are of the same nominal amount; but sometimes one class or set of the shares has a different par value from another class or set. Where this is the case, the equality which the law strives to maintain between the several shares is an equality of nominal values rather than a mere numerical equality. That is to say, where the capital consists partly of one-pound shares and partly of five-pound shares, each five-pound share is to be taken as the equivalent of five one-pound shares.¹

§ 519–§ 524. *WHERE A LARGER PROPORTION PAID IN UPON SOME SHARES THAN OTHERS.*

§ 519. **While Company a Going Concern — Calls, Dividends, Interest on Amounts paid in Advance of Calls.** — A case which is both more common and more difficult is where all the shares are of the same nominal amount but where a larger proportion has been paid in upon some of them than upon others. Generally, of course, the same amount is paid in on every share; and all calls must be uniform upon all the shares. But not infrequently some of the shares are issued as fully paid in exchange for property or services, while only a part of the nominal value of the other shares is paid in. Wherever this is the case, the law contemplates that in all other respects the shares shall stand upon an equality. It is true, where a greater

¹ *Wakefield Rolling Stock Co. Whiskey, etc. Co.*, 16 Times L. R. (1892), 3 Ch. 165. See also *Welsh* 246.

proportion has been paid upon some shares than upon others, any calls that may be made must be levied exclusively upon the latter class of shares until the inequality is wiped out.¹ But with this exception, which is apparent rather than real, shares of the same nominal amount stand upon an equality irrespective of the fact that a larger amount has been paid upon some of them than others. Thus, all dividends must be divided among the shareholders in proportion to the nominal amounts of their shares, and the directors have no authority to pay a dividend in proportion to the amounts respectively paid up on the shares.² To be sure, where a corporation receives from shareholders money paid in advance of calls, it may, by an agreement contemporaneous with the payment, lawfully treat the transaction as a loan, and agree to pay interest thereon;³ and, in that way, the advancing shareholders may secure some of the advantages that would accrue to them if dividends were payable proportionately to the amounts paid in on the several shares.

§ 520-§ 521. *In Winding-up or Liquidation.*

§ 520. **Where Assets are more than sufficient to return paid-up Capital.** — Not merely are dividends payable only in proportion to the nominal or par value of the shares irrespective of the fact that greater amounts may have been paid in on some of them than on others, but also, when a corporation is being wound up, any surplus that may remain after satisfying all creditors and returning to the shareholders the amount of capital respectively paid in by them, must be likewise distributed among the shareholders in proportion to the nominal amounts of their shares and without reference to the fact that some of them had paid in more than others.⁴

¹ *Great Western Tel. Co. v. Burnham*, 79 Wisc. 47; 47 N. W. 373; 24 Am. St. Rep. 698; *Bowen v. Kuehn*, 79 Wisc. 53.

² *Oakbank Oil Co. v. Crum*, 8 A. C. 65. Cf. *Gellerman v. Atlas Foundry, etc. Co.* (Wash.), 87 Pac. 1059.

But see *Richardson v. Vermont, etc. R. R. Co.*, 44 Vt. 613, 621.

³ See *Lock v. Queensland Land Co.* (1896), A. C. 461, and *infra*, § 548 and § 1340.

⁴ *Birch v. Cropper*, 14 A. C. 525; *Morrow v. Peterborough Water Co.*, 4 Ont. L. R. 324. Cf. *Eclipse Mining Co.*, 17 Eq. 490.

But see *Sheppard v. Scinde, etc. Ry. Co.*, 56 L. J. Ch. 866; 36 W. R. 1.

§ 521. **Where Assets are insufficient to return paid-up Capital.** — Where, in a winding-up, the assets after paying debts will not suffice to return all the paid-up capital, they must first be applied, if more has been paid in on some shares than on others, in repaying to the holders of the first class of shares the difference between the amounts paid up on them and on the other shares; and if the assets are not sufficient to make good this difference, then a call must be made on the other shareholders sufficient to do so. This result, in the ordinary case, where some of the shares are fully paid and some partly paid, may be reached by several different methods of accounting.

(a) *Method I.* — In the first place, the amount remaining unpaid on the partly-paid shares may be called in; and the sum thus obtained plus any assets remaining after the payment of debts and expenses should then be divided *pro rata* among all the shareholders,¹ all of whom, after the call, stand on an equality in respect to the amounts paid in. Of course where this method is adopted, there is no need actually to make and collect the full amount of the call; but by a short calculation the net amount to be paid or received by the shareholders of the two classes respectively may be determined, and the necessary distributions or assessments may then be made. This method of accounting is always available, and will in the long run prove the simplest.

(b) *Method II.* — Secondly, the assets in hand (after paying debts and costs of liquidation) may be used in returning to the holders of fully-paid shares the difference between the amounts paid on their shares and the amounts paid on the partly-paid shares; and the balance, if any, should then be distributed *pro rata* among all the shareholders in proportion to the par value of their shares.² When this method is adopted, the shareholders who have paid in the larger amounts cannot demand that interest

¹ *Anglesea Colliery Co.*, 1 Ch. 555.

² See *Scinde, etc. Bank Corporation*, 6 Ch. 53 n.; *Wakefield Rolling Stock Co.* (1892), 3 Ch. 165; *Driffeld Gas Light Co.* (1898), 1 Ch. 451.

But see *Eclipse Mining Co.*, 17 Eq. 490, where upon very peculiar facts it was held that the holders of paid-up shares were not entitled to be repaid the excess of the amounts deemed to have been paid on their

shares over the amount paid on the other shares which had been issued on special terms by an increase of capital, before any distribution was made to the holders of the latter class of shares, but that all the assets in hand after paying debts and costs should be distributed *pro rata* among all the shareholders without regard to the amounts paid up on their shares.

on the excess of the amounts paid on their shares over the amounts paid on the other shares be paid to them before any distribution is made to the other shareholders,¹ unless the advance payments were made under contracts stipulating for interest thereon.² Where the surplus assets are not sufficient to equalize the amounts paid up on the two classes of shares by returning the excess payments to the holders of the first class, then a sum sufficient for that purpose must be raised by a call on the second class of shares;³ but the matter is more complicated than where the former method of accounting is used.

(c) *Method III.* — The third method of accounting is still more complicated. According to that method, a sum should be raised by a call on the partly-paid shares sufficient to pay to the paid-up shareholders enough to make the two classes of shares, after the call on the first class and the distribution of the proceeds thereof among the holders of the second class, stand on an exact equality in respect to the amounts paid in: after this process of equalization has been completed, any assets in hand, remaining after payment of debts and expenses, should be distributed *pro rata* among all the shareholders.⁴

All these three methods of accounting lead to the same result; but as a practical matter it is submitted that the first is decidedly preferable.

§ 522. **Shares issued at a Premium.** — Sometimes shares are issued at a premium.⁵ In such cases, of course, the premium is absorbed in the general funds of the company; and on dissolution the holders of those shares cannot demand that the premium should be treated as capital paid in, and as such be returned to them. Any distribution of assets in winding-up must be made without regard to the circumstance that some of the shares were issued at a premium.⁶ The amount of the premium may be treated by the company as a reserve fund of accumulated profits.⁷

¹ *Ex parte Maude*, 6 Ch. 51.

⁴ *Anglo-Continental Corporation*

² *Exchange Drapery Co.*, 38 Ch. (1898), 1 Ch. 327.

D. 171; *Wakefield Rolling Stock Co.*

⁵ Cf. *infra*, § 775.

(1892), 3 Ch. 165.

⁶ *Driffeld Gas Light Co.* (1898),

³ *Provision Merchants Co.*, 26 1 Ch. 451.

L. T. 862.

⁷ *Hoare & Co.* (1904), 2 Ch. 208.

Cf. *infra*, § 1334.

although they have not been generally treated in that way.¹ The individual rights most commonly affected by agreements for preferences in favor of some shareholders are the rights of the several shareholders to participate equally in dividends;² but other purely individual rights of the shareholders stand on the same footing. Thus, the right of all the shareholders to share equally in a winding-up in the distribution of assets remaining after payment of the company's debts is sometimes altered by agreements whereby certain of the shareholders become entitled to a preference.³ So, the shareholders may agree that no call shall be made on certain of the shares unless it be necessary for payment of debts.⁴

§ 526. **Nomenclature.** — "*Preferred Shares*," "*Preference Shares*," "*Common Shares*," "*Ordinary Shares*." — When preferential rights, generally in respect to dividends, are given to any class of shares, those shares are called in England preferred or preference shares. In the United States, they are called preferred shares or preferred stock.⁵ In England, the other or deferred shares are called ordinary shares, while in America they are usually called common shares or common stock. The right to a preference in respect to dividends — that is to say, the right to receive a dividend of a certain rate per cent before any dividend is paid on the other shares — is not merely the most common kind of preferential rights, constituting the distinguishing feature of most preferred stock, but is also typical of the other preferential rights which may be created in a similar way and which may be reserved for subsequent and briefer consideration.

§ 527-§ 530. *Power to give Preference to some Shares in respect of Dividends.*

§ 527. **In general.** — The right to dividends is peculiarly the individual, private right of each shareholder. Dividends can be paid only when profits are earned and when therefore

¹ *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536; *Waterman v. Troy, etc. R. R. Co.*, 8 Gray (Mass.), 433. of so-called "special stock" which carried certain peculiar rights and which has little resemblance to the preferred shares so common in England and the United States. *Am. Tube Works v. Boston Machine Co.*, 139 Mass. 5; 29 N. E. 63.

² *Infra*, § 527-§ 530.

³ *Infra*, § 564.

⁴ *Infra*, § 571.

⁵ The statutes of Massachusetts, until recently, authorized the issue

creditors are not jeopardized. Moreover, the dividends, when paid, go into the private pocket of each shareholder. If, therefore, any shareholder chooses to waive his right to a dividend, in whole or in part, in favor of some other shareholder, neither the creditors nor the public nor any other shareholder is in any way affected or has any ground for complaint. Moreover, subsequent transferees of the shares who may take with notice of any such waiver would take subject thereto. The waiver or agreement would, to borrow an expression from the law of real property, "run with" the share as against all except *bona fide* purchasers for value. By means of these principles, the issue of preferred shares may often be sustained without the aid of any express enabling statute.¹

§ 528. **Creation of Preference at Organisation of Company by Incorporation Paper or Contemporaneous By-laws.** — Thus, if the incorporation paper divide the capital stock into preferred and ordinary or common shares, the holders of the former class of shares being entitled to a dividend up to a limited amount in preference to shareholders of the latter class, every signatory of the instrument and every person who may subsequently subscribe for shares assents to the arrangement; and furthermore all future transferees of shares are affected with notice of the contents of the instrument and, being therefore charged with notice of the preference given to the one set of shareholders, would take subject thereto. The legality and effectiveness of classifying the shares in this way in the incorporation paper may, accordingly, be regarded as settled.² Indeed, if a corporation at its organization by mere by-law divides its shares into preferred and common, the rights of the shareholders will be governed by the terms of that by-law.³

¹ See *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 178-179; *Higgins v. Lansingh*, 154 Ill. 301; 40 N. E. 362; *Wilson v. Parvin*, 119 Fed. 652; 56 C. C. A. 268.

² *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257; 77 N. E. 13; 112 Am. St. Rep. 607; *Nelson Coke Co. v. Pellatt*, 4 Ont. L. R. 481; *Harrison v. Mexican Ry. Co.*, 19 Eq. 358; *South Durham Brewery Co.*, 31 Ch. D. 261; in which last two cases the court held that an authorization of

preferred shares which was contained in the "articles of association" recorded contemporaneously with the memorandum of association was effective.

Cf. *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 178-179.

³ Cf. *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 178-179.

See also cases cited *supra* as to classification of shares in English articles of association.

§ 529. **Creation of Preference after Shares have been issued on an Equality.** — Even after shares have been issued upon an equal footing, the holders may by unanimous agreement reclassify them so as to give preferential rights to some of them.¹ This is often done in pursuance of some scheme of reorganization, when all the original shares are surrendered and new shares issued, some of which carry preferential rights. Without, however, such unanimous consent, where shares have been issued with equal rights, no preference can be given to some over the others,² — not even by a resolution or by-law passed by a majority of the shareholders. Thus, where shares as issued stood upon an equality, a by-law which attempts to confer a preference upon the shares of any shareholders who may pay a certain premium to the company is void as against a dissentient minority of the shareholders unless they have become barred by laches.³

§ 530. **Issue of new Shares with Preference over previously issued Shares.** — The same rule would seem to apply where a portion of the original authorized capital which had not been previously subscribed is proposed to be issued with a preference over the holders of the previously allotted shares;⁴ and shares

¹ For this purpose, where the stock-certificate has been indorsed to an assignee but before the transfer is registered, the assent of the transferor is not sufficient although the company have no notice of the transfer: *Campbell v. Am. Zylonite Co.*, 122 N. Y. 455; 25 N. E. 853; 11 L. R. A. 596.

² *Campbell v. Am. Zylonite Co.*, 122 N. Y. 455; 25 N. E. 853; 11 L. R. A. 596. The power to reorganize the capital by dividing the shares into classes is expressly conferred by a recent British statute. 7 Edw. VII, c. 50 (Companies Act, 1907), § 39.

³ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 179-180 (semble).

⁴ *Hutton v. Scarborough Hotel Co.*, 4 De G. J. & S. 672 (affirming s. c. 2 Dr. & Sm. 514). This decision was approved and declared to be "obviously correct" in *Andrews v. Gas Meter Co.* (1897), 1 Ch. 361, 368,

where a later decision between the same parties, *Hutton v. Scarborough Hotel Co.*, 2 Dr. & Sm. 521, was overruled. The American courts would probably agree: *Railroad v. Knoxville*, 98 Tenn. 1, 21; 37 S. W. 883.

But see *Hazlehurst v. Savannah, etc. R. R. Co.*, 43 Ga. 13; *Ingraham v. National Salt Co.*, 130 Fed. 676, 679 (headnote inadequate); 65 C. C. A. 54; *Wilson v. Parvin*, 119 Fed. 652; 56 C. C. A. 268.

The rule as stated in the text may, however, be evaded by issuing in payment for property acquired by the company ordinary shares together with "certificates of indebtedness" sufficient to cover guaranteed dividends thereon for a period of years: *Ingraham v. National Salt Co.*, 130 Fed. 676; 65 C. C. A. 54. Cf. *Strickland v. Nat. Salt Co.* (N. J.), 64 Atl. 982 (semble).

issued by increasing the authorized capital cannot well be differentiated in this respect from the previously unissued shares of the original capital.¹ In England, however, it is now held, in spite of an early decision to the contrary,² that a company may by altering its articles of association take to itself the power of increasing its capital by the issue of preferred shares, and may then proceed to issue the shares of the new capital with a preference over the shares of the original capital.³ The hardship of this doctrine in upsetting the supposedly vested right of the original shareholders to rank equally with any shares that might subsequently be issued is perhaps more apparent than real. For if the corporation should issue bonds or debentures, as unquestionably it might lawfully do, the position of the original shareholders would be worse rather than better than if the money were raised by an issue of preferred shares.⁴ Nevertheless, as already stated, the issue of preferred shares upon an increase of capital except by unanimous consent is in the United States generally held to be unwarranted. Of course, if the issue of shares with a preference over the existing shares is authorized by the incorporation paper or by regulations which were adopted prior to the issue of the deferred or common shares and of which the subscribers to the common shares had either actual or constructive notice, the issue of the preferred shares is quite lawful.⁵ And even if preferred shares are issued by a mere majority vote of the existing shareholders when a unanimous vote is requisite, yet subsequent unanimous acquiescence will be equivalent to prior authorization, and will validate the issue.⁶

¹ *Ernst v. Elmira Mun. Imp. Co.*, 24 N. Y. Misc. Rep. 583; 54 N. Y. Supp. 116.

The only possible distinction is that upon an increase of capital the original shareholders have generally an option of subscribing to the new shares in proportion to their holdings of the old, and are consequently less injuriously affected by the annexing of preferential rights to the new shares than if no such option had existed.

² *Hutton v. Scarborough Hotel Co.*, 2 Dr. & Sm. 521.

³ *Andrews v. Gas Meter Co.* (1897), 1 Ch. 361. Cf. *Hinckley v. Schwartzchild, etc. Co.*, 45 N. Y. Misc. 176; 91 N. Y. Supp. 893.

⁴ *Harrison v. Mexican Ry. Co.*, 19 Eq. 358, 367-368.

⁵ *Harrison v. Mexican Ry. Co.*, 19 Eq. 358; *South Durham Brewery Co.*, 31 Ch. D. 261.

⁶ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159. But see *Ashbury v. Watson*, 30 Ch. D. 376. Cf. *infra*, § 534.

§ 531. **Statutes authorizing Issue of Preferred Shares.** — Sometimes statutes expressly authorize the issue of preferred shares and define the incidents thereof. It is submitted, however, that such statutes should not be construed as impliedly prohibiting the issue of preferred shares with different incidents and rights, by any method that would be permissible without affirmative statutory authorization. A statute which in form is enabling may by implication limit the number of preferred shares which the corporation may issue. A statute authorizing the issue of preferred shares to an amount equal to two thirds of the capital actually paid in means capital paid in at the time the issue is authorized by resolution rather than the time when the preferred shares are actually issued.¹

§ 532. **What words Sufficient to authorize Issue of Preferred Shares carrying sundry Preferences.** — However this may be, the question may often arise what language is sufficient to authorize the issue of shares with preferential rights; and this question is essentially the same whether the language to be construed is found in a statute, incorporation paper, or contract. It has been held that authority to issue new shares of such nominal amount and on such conditions as a special resolution might determine does not justify the issue of preferred shares;² and the same has been held to be true of authority to issue shares “of such nominal value and subject to such conditions as to the payment of calls and proportion of profits as may be determined by the company.”³ On the other hand, power to issue new shares “with and subject to such rules, regulations, privileges and conditions” as the company in general meeting may determine will warrant the issue of preferred shares.⁴ A clause empowering the company to issue shares with such preferences as it may deem expedient authorizes the issue of shares having a preference in respect to capital as well as in respect to dividends;⁵

¹ *Continental Varnish, etc. Co. v. Secretary of State*, 87 N. W. 901; 128 Mich. 621.

tions as the general meeting shall direct.” ² *Moss v. Syers*, 32 L. J. Ch. 711.

³ *Melhado v. Hamilton*, 28 L. T. N. S. 578 (affirmed in 29 L. T. N. S. 364).

⁴ *Harrison v. Mexican Ry. Co.*,

19 Eq. 358.

⁵ *Bangor Slate Co.*, 20 Eq. 59

Cf. *Hutton v. Scarborough Hotel Co.*, 2 Dr. & Sm. 521, where the original articles authorized the increase of capital “on such conditions as the general meeting shall direct.” Cf. *London & New York Investment Co.* (1895), 2 Ch. 860. See also *infra*, § 564.

and power to issue preferred shares includes power to issue “guaranteed” shares,¹ for there is no substantial difference between the two. Indeed, it has been said that where a company is empowered to issue preferred shares, no conditions or restrictions being attached to the authority, the company may attach such conditions as it chooses.² Where a statute authorized a railway company to “increase their capital in such manner as they may deem most advisable,” the Virginia Court of Appeals reached the somewhat startling conclusion that the company was authorized to issue shares which should not merely carry a preferential cumulative dividend, but should also be entitled to the dividend whether sufficient profits were earned or not.³ And a Massachusetts statute authorizing a corporation to “issue preferred stock . . . the said company to give its guaranty that each share of stock shall receive semi-annual dividends of four dollars on each share,” was held to authorize the issue of stock the dividends upon which should be paid whether or not profits should be earned.⁴ But in general it is submitted that statutes should not be held to authorize such anomalous forms of security without very explicit language.

§ 533. **Injunction against unauthorized Issue of Preferred Shares.** — Ordinarily, where without due authority the company is about to issue preferred shares, any shareholder may secure an injunction against the issue. In one case, however, where such a preliminary injunction was asked for, Vice-Chancellor Knight Bruce, without considering whether or not the proposed issue was *ultra vires*, refused to grant the application, upon the ground that to interfere at that stage in a manner which the court might on final hearing determine to be improper would be more likely to do harm than good, when some of the new preferred shares had been already issued and when the vast majority of the shareholders favored the issue.⁵

¹ *Prouty v. Michigan, etc. R. R. Co.*, 1 Hun (N. Y.) 655, 661. 320, 354. See also *infra*, § 542, § 543.

² *Hackett v. Northern Pac. Ry. Co.*, 36 N. Y. Misc. 583; 73 N. Y. Supp. 1087. ⁴ *Williams v. Parker*, 136 Mass. 204. The case proceeds in a large measure upon local considerations peculiar to Massachusetts.

³ *Gordon's Exrs. v. Richmond, etc. R. R. Co.*, 78 Va. 501 (headnote inadequate). ⁵ *Fielden v. Lancashire, etc. Ry. Co.*, 2 De G. & Sm. 531.

Cf. *Skiddy v. Atlantic, etc. R. R. Co.*, *Re Stewart's Petition*, 3 Hughes Co., 32 Fed. 350. Cf. *Mackintosh v. Flint, etc. R. R. Co.*, 32 Fed. 350.

§ 534. **Effect of unwarranted issue of Preferred Shares — Estoppel — Acquiescence.** — Even if preferred shares are unwarrantably issued, the issue is not a mere nullity. Thus, the validity of the preferred shares cannot be called in question by those who received and for several years held them, collecting the preferred dividend thereon.¹ Upon this principle, one who actively promotes an issue of preferred stock and subscribes for a large number of shares thereof cannot recover back the amount paid therefor after the company has become insolvent, upon the ground that the issue was illegal and that the consideration had therefore failed.² Moreover, if all the shareholders acquiesce in the illegal issue of preferred shares, then on the principles set forth above the improper issue is condoned and validated.³ And so, if the corporation resolves to issue preferred shares without any preference as to capital and the officers wrongfully insert in the certificates of stock a clause conferring a preference in respect to capital, this preference is valid if the common shareholders acquiesce in the issue.⁴ Where, however, money is advanced to a company upon the agreement that payment shall be made in its preferred shares, the lender is entitled, upon the discovery that the company had no power to create preferred shares, to a return of the money, notwithstanding the fact that the corporation may in the meantime have acquired by act of the legislature power to issue the shares;⁵ in this case the intended subscriber to the preferred shares had been guilty of no laches sufficient to raise an estoppel.

¹ *Branch v. Jesup*, 106 U. S. 468, 481; 1 Sup. Ct. 495. Cf. *Long v. Alstyne*, 31 Mich. 76; 18 Am. Rep. 156.

Guelph Lumber Co., 31 Up. Can. C. P. 129; *Manufacturers' Paper Co. v. Co.*, 141 Mass. 454; 5 N. E. 852.

Allen-Higgins Co., 154 Fed. 906. A different rule prevailed in Massachusetts as to an illegal issue of so-called "special stock," which

under certain conditions the statutes of that state authorized to be created: *Am. Tube Works v. Boston Machine Co.*, 139 Mass. 5; 29 N. E. 63.

² *Banigan v. Bard*, 134 U. S. 291; 10 Sup. Ct. 565. Cf. *Lockhart v. Van*

Anthony v. Household Sewing Machine Co., 16 R. I. 571; 18 Atl. 176; 5 L. R. A. 575.

But cf. *Manufacturers' Paper Co. v. Allen-Higgins Co.*, 154 Fed. 906.

§ 535—§ 539. *Alteration of Preferential Rights.*

§ 535. **In general.** — Where shares are issued with preferential rights whether the issue was originally valid or has become so by acquiescence of the deferred shareholders, the right to the preference is a vested one which is as sacred from subsequent alteration by the company as is the ordinary right to equality of shares which are issued without preference one over another.¹ Thus, a preferred shareholder may enjoin the company from permitting the holders of common shares upon payment of a bonus to exchange them for preferred shares which should rank *pari passu* with the preferred shares previously issued, and that too although the preferential rights of the earlier issue of preferred shares was created by a precisely similar option of exchange of common shares for preferred, which former exchange of common shares for preferred had been validated by long-continued acquiescence of all the shareholders.² So, where preferred shares are issued under statutory authority, a subsequent arrangement by which the shares held by persons assenting to the scheme are exchanged for shares ranking on a parity with the common or deferred shares does not affect the non-concurring preferred shareholders.³

§ 536. **Preference created by Incorporation Paper.** — Where the method of dividing profits between preferred and ordinary shareholders is fixed by the incorporation paper, no alteration therein can be made (unless in the method, if any, provided by law for altering that instrument); and this is true although the relative rights of shareholders are not required by law to be determined by that instrument.⁴ One judge has expressed the opinion that not even the unanimous assent of the shareholders would authorize an alteration in their relative rights as fixed by the incorporation paper.⁵ To be sure,

¹ A recent British statute authorizes companies to alter or abrogate preferential rights attaching to a certain class of shares provided a majority of the shareholders of that class assent. 7 Edw. VII, c. 50 (Companies Act, 1907), § 39.

² *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159 (headnote inadequate), affirming s. c. 12 Hun 54.

³ *West Chester, etc. R. R. Co. v. Jackson*, 77 Pa. St. 321 (headnote misleading).

⁴ *Ashbury v. Watson*, 30 Ch. D. 376. See *supra*, § 120.

⁵ *Ashbury v. Watson*, 30 Ch. D. 376, 384 (semble), per Bagallay, L. J.

if the incorporation paper after providing for the issue of preferred shares with certain preferential rights authorizes the company to alter those rights, the shares would be taken subject to this power of alteration.¹ For instance, where an incorporation paper, after providing for shares carrying a non-cumulative preferential dividend of seven per cent per annum, further provides that any shares of the present or any increased capital may be issued with such rights and priorities as the company may from time to time determine, the company on increasing its capital may issue shares ranking *pari passu* with the original preferred shares.² Where the law provides a method of altering the incorporation paper, the power to alter the rights of preferred or common shareholders *inter sese*, as fixed in that instrument, depends on different considerations, and would seem to exist to the same extent as (and no further than) the power to alter such rights when fixed by mere regulations or by-laws of the company. Where a company's incorporation paper provides that the preferred shares shall carry a preferential dividend at a certain rate the corporation cannot under a general power to alter the instrument make an amendment reducing the preferential dividend.³

§ 537. **Effect of Proceedings for Reduction of Capital.** — The effect of proceedings for the reduction of capital upon the preferential rights of preferred shareholders is considered in detail below.⁴

§ 538. **Effect of Consolidation with another Corporation.** — The effect of a consolidation with another corporation upon the rights of preferred shareholders cannot be described in general terms applicable to all cases. In some cases, the "consolidation" may take the form of a formal dissolution and winding-up of the constituent companies. In such cases the rights of preferred shareholders in the dissolved corporation will be governed by the principles set forth below relating to the rights of preferred shareholders in winding-up or liquidation. In other cases, there is a coalescing or merger of the constituent corporations without any formal dissolution of either

¹ *Welsbach Incandescent Gas Light Co.* (1904), 1 Ch. 87.

² *Underwood v. London Music Hall* (1901), 2 Ch. 309.

³ *Pronick v. Spirits Distributing Co.*, 58 N. J. Eq. 97; 42 Atl. 586.

⁴ *Infra*, § 656, § 672–§ 674.

of them, the new company being regarded as the successor of both of them. In such cases, the statute under which the consolidation is effected usually provides explicitly that the consolidated company shall be liable for the obligations of the old companies. It is, to say the least, extremely doubtful whether such a provision has any application to the preferential rights of preferred shareholders. It is easy to suggest many questions which are very hard to answer. For instance, if both of the constituent corporations have issued preferred shares, do both stand upon an equality, or does one outrank the other? In a New York case, where the terms of the consolidation agreement seem clearly to have contemplated that the rights of holders of preferred stock in one of the constituent companies should continue unaffected by the consolidation, the right of such a shareholder was enforced against profits earned by the consolidated company.¹ On the other hand, in a very recent case arising under the New Jersey statute, the Vice-Chancellor of that state conceded that the right to a continuance of the preferred cumulative dividend might be terminated for the future by the consummation of a consolidation, but held that a consolidation agreement which provided for a surrender or commutation of the right to cumulative dividends which were overdue at the time of the consolidation, and for payment of which profits had been earned and accumulated as a reserve fund, was unlawful as against a dissenting preferred shareholder.² Certain it is that the mere issuance of preferred shares should not be deemed a waiver of an existing statutory right to consolidate;³ the only question is how the rights of the preferred shareholders are to be accommodated to the changed conditions brought about by the consolidation.

§ 539. **Waiver of Preference.** — A preferred shareholder may always waive the preferential rights attaching to his shares, and as a result of such waiver the shares will be converted, virtually, into common or ordinary shares,⁴ except that if the common shares have any advantages over the preferred shares

¹ *Boardman v. Lake Shore, etc.* the court in *Colgate v. U. S. Leather Ry. Co.*, 84 N. Y. 157. *Co.* (N. J.), 67 Atl. 657.

² *Colgate v. U. S. Leather Co.* (N. J.), 67 Atl. 657. ⁴ *Pendleton v. Harris-Emery Co.*, 124 Iowa 361; 100 N. W. 117.

³ This was distinctly declared by

in respect to voting rights, or in respect to being subject to no limit as to the amount of dividends payable, or otherwise, no such "waiver" by a preferred shareholder can have the effect of diminishing those advantages without the consent of the ordinary shareholders.

No attempt to coerce the preferred shareholders into waiving their rights will be tolerated. Hence the payment of interest upon dividends in arrear upon cumulative preferred shares to such preferred shareholders as assent to a change in the incorporation paper whereby the preferential dividend is made non-cumulative would be unlawful.¹

§ 540-§ 548. *Status of Preferred Shareholders as Members and not Creditors of the Company.*

§ 540. Preferred Shareholders entitled to same Rights and Subject to same Liabilities as other Shareholders except as otherwise provided. — The preferential rights which preferred shares may carry may be and, as will presently be explained at length, are exceedingly diverse; but however various they may be, and whatever phraseology may be used in creating them, the fundamental fact remains that the holders are members of the corporation.² Consequently, a subscription to preferred shares cannot be treated as a loan of money or extension of credit to the corporation.³

Indeed, preferred shareholders are shareholders, and as such are entitled to all the rights, and are subject to all the liabilities, which attach to ordinary shareholders, except in so far as those rights or liabilities may be varied, expressly or by clear implication, by the statute, by-law, or convention under which the preference is created. Thus, preferred shareholders have no greater rights than ordinary shareholders to enjoin the creation or funding of debts by the company,⁴ or other matters of internal manage-

¹ *Willcox v. Trenton Potteries Co.*, 64 N. J. Eq. 173; 53 Atl. 474 (seemable; the points decided being that the agreement in question should not be construed so as to authorize such payment, and that, if it should, the whole agreement and scheme would not on that account be vitiated).

² Cf. *People ex rel. S. Cohn & Co. v. Miller*, 180 N. Y. 16; 72 N. E. 525.

³ *Grover v. Cavanaugh* (Ind.), 82 N. E. 104.

⁴ *Thompson v. Erie Ry. Co.*, 11 Abb. Pr., N. S., 188.

ment that may affect them prejudicially, or be thought so to do. Conversely, preferred stockholders are subject to any statutory liability to creditors imposed upon holders of shares.¹ Even a statute providing that preferred shareholders shall be free from any liability to creditors does not exempt them from a liability in favor of creditors imposed by another statute upon shareholders who accept a return of capital in the shape of illegal dividends or otherwise,² and *a fortiori* does not exempt them from the ordinary liability of shareholders to pay the par value of their shares to the company or its receiver.³ Moreover, any statutes which apply to shares in general are *prima facie* applicable to preferred shares. Consequently, a statute regulating the times or periods for the declaration of dividends applies to dividends on preferred shares.⁴

§ 541. **Preferred Shareholders not entitled to Rights of Creditors.** — As preferred shareholders are members of the company, it follows that they are not creditors, and are not entitled, even in respect to their preferential dividends, to the rights of creditors. Hence, they cannot claim payment of their preferential dividend except out of funds properly available for the payment of dividends, — that is, out of profits. Their claim is, therefore, subject to the rights of creditors, secured and unsecured, — even those whose debts were contracted after the issue of the preferred shares⁵ and with knowledge of the rights attaching thereto.⁶ Moreover, preferred shareholders are not taxable as holders of certificates of indebtedness of the company.⁷ Similarly, preferred stock cannot be charged up as a liability in determining whether the indebtedness of a railway company is so great as to justify it in refusing to run separate passenger trains.⁸

¹ *Railroad Co. v. Smith*, 48 Oh. St. 219; 31 N. E. 743.

² *American Steel, etc. Co. v. Eddy*, 89 N. W. 952; 130 Mich. 266.

³ *Kirkpatrick v. American Alkali Co.*, 140 Fed. 186.

⁴ *Marquand v. Federal Steel Co.*, 95 Fed. 725.

⁵ *St. John v. Erie Ry. Co.*, 22 Wall. 136; *Warren v. King*, 108 U. S. 389.

Cf. Mercantile Trust Co. v. Baltimore, etc. R. R. Co., 82 Fed. 360.

Where the preferred shares are to be

a lien on the company's property "next after its indebtedness," debts contracted subsequently as well as prior to the issue of the preferred shares are referred to: *Warren v. King*, *ubi supra*.

⁶ *Warren v. King*, 108 U. S. 389, 400; 2 Sup. Ct. 789.

⁷ *Miller v. Ratterman*, 47 Oh. St. 141; 24 N. E. 496.

⁸ *People ex rel. Cantrell v. St. Louis, etc. R. R. Co.*, 176 Ill. 512; 52 N. E. 292; 35 L. R. A. 656.

§ 542. **What Circumstances insufficient to confer on Preferred Shareholders Rights of Creditors.** — That the preferred shareholders may have been originally creditors, having surrendered bonds of the company in exchange for the preferred shares, does not make them any the less members as distinguished from creditors of the company.¹ Moreover, the fact that the preferred dividend may be called “interest” — a term more appropriate to compensation for the use of money lent — is immaterial;² and, also, the case is not altered because the statute under which the company is organized designates the preferred shares as “stock” simply, and not *capital* stock.³ Nor is the fact that the preferred stockholders do not possess the right of voting at shareholders’ meetings sufficient evidence that they should be deemed creditors rather than members of the corporation.⁴ Indeed, even if payment of the preferred dividend is “guaranteed” by the company, the preferred shareholders are entitled to nothing except out of net profits: the guarantee will be construed to apply only to payment out of any funds legally available for dividends.⁵ And, of course, a guarantee

¹ *St. John v. Erie Ry. Co.*, 22 Wall. 136. Cf. *Warren v. King*, 108 U. S. 389; 2 Sup. Ct. 789; *Field v. Lamson, etc. Co.*, 162 Mass. 388, 390–391; 38 N. E. 1126; 27 L. R. A. 136.

But see *McVity v. Albro Co.*, 90 N. Y. App. Div. 109; 86 N. Y. Supp. 144; affirmed short in 180 N. Y. 554; 73 N. E. 1126 (where the creditor was allowed to avoid the contract by which he accepted the guaranteed shares and recover on his original claim).

² *Warren v. King*, 108 U. S. 389, 399; 2 Sup. Ct. 789; *Branch v. Jesup*, 106 U. S. 468, 475; 1 Sup. Ct. 495; *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664, 669; 24 C. C. A. 271; 36 L. R. A. 826; *M’Laughlin v. Detroit, etc. Ry. Co.*, 8 Mich. 100.

Cf. *Mercantile Trust Co. v. Baltimore, etc. R. R. Co.*, 82 Fed. 360; *State ex rel. Thompson v. Cheraw, etc. R. R. Co.*, 16 S. Car. 524; *Ohio College v. Rosenthal*, 45 Oh. St. 183; 12 N. E. 665; *Waterman v. Troy, etc. R. R. Co.*, 8 Gray (Mass.) 433.

³ *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110, 127 et seq.; *State ex rel. Thompson v. Cheraw, etc. R. R. Co.*, 16 S. Car. 524.

⁴ *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664, 671; 24 C. C. A. 271; 36 L. R. A. 826; *Miller v. Ratterman*, 47 Oh. St. 141; 24 N. E. 496.

⁵ *Stevens v. South Devon Ry. Co.*, 9 Hare 313, 325; *Lockhart v. Van Alstyne*, 31 Mich. 76; 18 Am. Rep. 156; *Taft v. Hartford, etc. R. R. Co.*, 8 R. I. 310; 5 Am. Rep. 575; *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110; *Miller v. Ratterman*, 47 Oh. St. 141; 24 N. E. 496; *Field v. Lamson, etc. Mfg. Co.*, 162 Mass. 388, 392–394; 38 N. E. 1126; 27 L. R. A. 136; *Long v. Guelph Lumber Co.*, 31 Up. Can. C. P. 129.

See also *Branch v. Jesup*, 106 U. S. 468 (headnote inadequate); 1 Sup. Ct. 495; *Mercantile Trust Co. v. Baltimore, etc. R. R. Co.*, 82 Fed. 360; *Waterman v. Troy, etc. R. R. Co.*, 8 Gray (Mass.) 433.

But see *Williams v. Parker*, 136

by another corporation of the punctual payment of the preferred dividend would not affect in any way the nature of the preferred shareholders' position.¹ Even an agreement on the company's part to create no mortgage "except expressly subject to the prior lien" of the preferred shareholders will not make the preferred shareholders creditors.² A so-called mortgage or deed of trust of the company's property to secure the payment of preferential dividends, even when containing provisions for foreclosure or entry by the trustee in case of default, will be construed as a mere agreement between shareholders and not as evincing an intention that the "preferred stockholders" should be deemed to be creditors.³

§ 543. **Express agreement that Preferred Shareholders shall have Rights of Creditors Ultra Vires.** — In fact, even an express agreement to pay the preferential dividend whether or not profits sufficient for the purpose be earned would be *ultra vires* as a return of capital to shareholders,⁴ and *a fortiori* a pledge or appropriation of a part of the company's capital to secure such

Mass. 204; *McVity v. Albro Co.*, 90 N. Y. App. Div. 109; 86 N. Y. Supp. 144; affirmed short in 180 N. Y. 554; 73 N. E. 1126.

¹ *Miller v. Ratterman*, 47 Oh. St. 141, 161-162 (headnote inadequate); 24 N. E. 496. Cf. *infra*, § 1338.

² *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664; 24 C. C. A. 271; 36 L. R. A. 826; *Miller v. Ratterman*, 47 Oh. St. 141; 24 N. E. 496.

³ *Miller v. Ratterman*, 47 Oh. St. 141, 159 et seq.; 24 N. E. 496; *Black v. Hobart Trust Co.*, 53 Atl. 826; 64 N. J. Eq. 415; affirmed short in 56 Atl. 1131; 65 N. J. Eq. 769; *Guaranty Trust Co. v. Galveston City R. R. Co.*, 107 Fed. 311; 46 C. C. A. 305.

But see *Burt v. Rattle*, 31 Oh. St. 116; *Gordon's Exrs. v. Richmond, etc. R. R. Co.*, 78 Va. 501; *Skiddy v. Atlantic, etc. R. R. Co., Re Stewart's Petition*, 3 Hughes, 320, 354; *Fitch v. Wetherbee*, 110 Ill. 475.

⁴ *Lockhart v. Van Alstyne*, 31 Mich. 76; 18 Am. Rep. 156; *Painesville, etc. R. R. Co. v. King*, 17 Oh.

St. 534; *Ohio College v. Rosenthal*, 45 Oh. St. 183, 194; 12 N. E. 665; *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664 (headnote inadequate); 24 C. C. A. 271; 36 L. R. A. 826; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516; 76 N. E. 707.

Cf. *Phillips v. Eastern R. R. Co.*, 138 Mass. 122, 135-138; *McVity v. Albro Co.*, 90 N. Y. App. Div. 109; 86 N. Y. Supp. 144; affirmed short in 180 N. Y. 554; 73 N. E. 1126; *Guaranty Trust Co. v. Galveston City R. R. Co.*, 107 Fed. 311; 46 C. C. A. 305; *Smith v. Alabama Fruit Growing, etc. Ass'n*, 123 Ala. 538; 26 So. 232 (where a bond conditioned for payment of dividends by obligor company on shares held by obligee was held void).

But see *Gordon's Exrs. v. Richmond, etc. R. R. Co.*, 78 Va. 501; *Skiddy v. Atlantic, etc. R. R. Co., Re Stewart's Petition*, 3 Hughes 320, 354; *Williams v. Parker*, 136 Mass. 204; *Fontana v. Pacific Can Co.*, 129 Cal. 51; 61 Pac. 580.

a dividend is likewise illegal.¹ A guarantee of dividends whether profits are earned or not is no less *ultra vires* because it may have been given in part consideration for services rendered to the company.² Likewise, a mortgage of property of the company to secure to a shareholder a return of his capital, in preference to creditors, in a winding-up of the company, is illegal and void.³ To be sure, in one case where a company had issued scrip, convertible into mortgage bonds at the option of the holder, to represent preferential dividends for the payment of which no profits were available, the Supreme Court of Vermont held that the scrip certificates were enforceable obligations of the company although no sufficient profits for their payment had ever been earned.⁴ The case proceeds upon the ground of estoppel, and lends no color to the view that dividends on preferred shares should stand in respect to the matter before the court on any different footing from dividends on common or ordinary shares. Nevertheless, it is submitted that a contrary decision would have been preferable. Where a corporation buys property and in payment therefor agrees to issue paid-up shares and to pay a certain sum in annual cash instalments, any dividends declared on the shares in the meantime to be applied in reduction of the cash instalments, the fact that such annual instalments equal dividends at a certain rate on the shares does not make the agreement void as an evasion of the rule which prohibits a corporation from guaranteeing dividends on its own shares.⁵

§ 544. **Further Explanation of Rule that Preferred Shareholders are not Creditors.** — Of course, as respects preferential dividends that are earned and declared, the preferred shareholders occupy the position of creditors; and perhaps in some

¹ *Guinness v. Land Corporation*, 22 Ch. D. 349; *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664 (headnote inadequate); 24 C. C. A. 271; 36 L. R. A. 826.

² *Elevator Co. v. Memphis, etc. R. R. Co.*, 85 Tenn. 703; 5 S. W. 52; 4 Am. St. Rep. 798. Cf. *Smith v. Alabama Fruit Growing, etc. Ass'n*, 123 Ala. 538; 26 So. 232.

³ *Boney v. Williams*, 55 N. J. Eq. 691; 38 Atl. 189; *Reed v. Helois*

Carbide, etc. Co., 64 N. J. Eq. 231, 244-245; 53 Atl. 1057; *Black v. Hobart Trust Co.*, 53 Atl. 826; 64 N. J. Eq. 415; affirmed short in 56 Atl. 1131; 65 N. J. Eq. 769; *Reagan v. First Nat. Bank*, 157 Ind. 623.

⁴ *Chaffee v. Rutland R. R. Co.*, 55 Vt. 110.

⁵ *Strickland v. Nat. Salt Co.* (N. J.) 64 Atl. 982 (semble); *Ingraham v. Nat. Salt Co.*, 130 Fed. 676; 65 C. C. A. 54.

cases the necessity for a declaration of the preferential dividend when earned may be dispensed with by the terms of the agreement stipulating for the preference.¹ Although preferred shareholders are to be postponed to creditors, of course the principal of all the company's indebtedness need not be paid off before paying the preferred dividend;² all that is meant is that the preferential dividends can only be paid out of funds that might legally be used for ordinary dividends. The case is not altered in this respect by the fact that at the organization of the company its declared policy was to contract no debts, the indebtedness having been subsequently contracted for the common benefit of both classes of shareholders.³

§ 545. *Sullivan v. Portland, etc. R. R. Co.*, 94 U. S. 806. — A very peculiar case in the United States Supreme Court would seem to be founded on the principle that preferred shareholders cannot by any contract or agreement with the company entitle themselves to the rank of creditors. A railway company had issued certificates of indebtedness bearing interest at the rate of ten per cent *per annum*, and redeemable at any time at the pleasure of the company. These certificates were a first lien on a part of the company's line. The corporation had also issued preferred shares which were entitled to a preferential dividend at the same rate, — ten per cent *per annum*. The company proposed to the certificate-holders to refrain for several years from exercising its privilege of redeeming the certificates in consideration of the agreement by the certificate-holders to accept six per cent yearly in lieu of ten, the money thus saved to the company to be applied in paying dividends to those preferred shareholders who should agree to accept new six per cent preferred stock instead of the original ten per cent stock. This proposition having been accepted by the certificate-holders and by some of the preferred shareholders, the company's entire line of railway was sold under a mortgage which as to the portion covered by the lien of the certificates was a junior charge. Those preferred shareholders who had accepted the above-stated proposition filed a bill to compel the purchaser to pay to them as dividends the four per cent annual interest released

¹ See *infra*, § 561, § 562.

² *Belfast, etc. R. R. Co. v. Belfast*,

³ *Belfast, etc. R. R. Co. v. Belfast*, 77 Me. 445; 1 Atl. 362.

77 Me. 445; 1 Atl. 362.

by the certificate-holders. But the court held that the plaintiffs were not creditors of the company, but mere shareholders or members, and that they were not entitled as against creditors to the security of the certificate-holders, which was prior to the mortgage under which the sale was made, and that therefore the bill should be dismissed.¹ It is submitted that the gist of the case is that the preferred shareholders could not be entitled to the rights of creditors or mortgagees, and therefore could not have priority over the mortgage under which the road was sold.

§ 546. **Tests for distinguishing Shareholders from Creditors.** — Although preferred shareholders are thus separated from creditors by a line of demarcation, yet it is possible to imagine a form of security the holders of which would lie very close to the line between shareholders and creditors. For instance, the holders of income bonds are creditors of the corporation; but in many respects their rights are very similar to those of preferred shareholders. One distinction is that an income bondholder has generally no vote or voice in the corporate management, while the holder of preferred shares has usually the same voting rights as a holder of the same number of ordinary shares. But sometimes preferred shareholders have no vote; and the difference between such preferred shareholders and income bondholders is for practical purposes not much more than a difference in name. Nevertheless, even such preferred shareholders, although shorn of their voting rights, are yet members of the company, while the income bondholders occupy the theoretically very different position of outsiders who hold contractual obligations of the company.² According to some authorities, the distinction between preferred shareholders and creditors of the corporation lies in the fact that sooner or later there must come a time for repaying creditors while preferred shareholders may be entitled to a perpetual income;³ but this cannot be the right test, for some securities, such as the English "perpetual debenture stock" or the income bonds of some American companies, carry the right to interest in perpetuity, and yet the holders thereof are creditors as opposed to members of the corporation. At any

¹ *Sullivan v. Portland, etc. R. R. Co.*, 94 U. S. 806.

² *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159, 177-178.

³ Cf. *Re Bodman* (1891), 3 Ch. 135 (containing a good discussion).

rate, little good can come from puzzling over anomalous kinds of securities the holders of which lie close to the line between preferred shareholders and creditors. Such legal monsters serve only to obscure a distinction that in the main is easy to make. We have little difficulty in distinguishing a girl from a fish; but, if we should encounter a mermaid, we might have trouble in determining in which category the creature should be placed. A subscriber, however, to "preferred stock" has a right to insist that the certificate given to him shall be unambiguous, and shall not leave in doubt the question whether he is to be deemed a member or a creditor of the company.¹

§ 547. **Statutes conferring on Preferred Shareholders some of the Rights of Creditors.** — Express legislation sometimes confers upon preferred shareholders rights which usually belong only to creditors, and which without such statutory sanction the policy of the law would prevent from being conferred upon shareholders. Such statutes frequently confuse or obliterate the distinction between shareholders and creditors. For example, a Maryland statute authorizes the issue of so-called preferred stock the holders of which have priority over subsequent mortgages.² So some statutes have been held to authorize the issue of "preferred stock" upon which dividends should be payable whether or not profits be earned.³ The rights thus given to "preferred stockholders" by statute may even be such as to induce the court to conclude that, in spite of the name,⁴ they are creditors and not members of the company. Thus, where an Ohio statute authorized the issue of "preferred stock" which was to be redeemed by the company at a fixed time, and the dividends upon which were guaranteed by the company, the payment of the principal and interest or "dividends" being secured by a bond and mortgage, and the holders of the stock having no right to vote

¹ *State ex rel. Thompson v. Cherraw, etc. R. R. Co.*, 16 S. Car. 524.

² *Heller v. Marine Bank*, 89 Md. 602; 43 Atl. 800; 73 Am. St. Rep. 212; 45 L. R. A. 438; *Rogers v. Citizens' Nat. Bank*, 93 Md. 613; 49 Atl. 843. Cf. *Gordon's Exrs. v. Richmond, etc. R. R. Co.*, 78 Va. 501.

³ *Williams v. Parker*, 136 Mass. 204. Cf. *Cotting v. New York, etc. R. Co.*, 54 Conn. 156; 5 Atl. 851

(where a statute authorizing issue of preferred stock by an embarrassed railway company was held to authorize the payment of the preferential dividends out of future earnings without first making good a prior loss or impairment of capital).

⁴ That the word "stock" does not indicate *per se* that the holders are members and not creditors of the company, see *supra*, § 496.

and being declared by the statute exempt from a liability to creditors, which by the state constitution attached to all members of corporations, the court concluded that the so-called "preferred stockholders" were really not members but creditors of the company.¹

§ 548. "Interest-bearing Stock." — A word or two of further explanation of so-called interest-bearing stock. Where any undertaking is entered upon involving the construction of extensive works, a greater or less period of time must elapse after the capital is contributed before it can become productive. A railway company, for example, cannot earn profits until several years after its organization. In such cases, in former days — for the practice is much less common now than formerly — the company would agree, as an incentive to investors, to pay "interest" on the amount of capital paid in on the several shares, until the line should be completed. If such an agreement were interpreted as a contract to pay interest during the period of construction, during which in the nature of things no profits could be earned, it might, on the principles stated above, be illegal and void,² except so far as clearly sanctioned by statute.³ But, wherever possible, the agreement should be construed to mean that, after the completion of the road and its establishment on a profit-earning basis, the company would apply the profits in paying to those who had contributed to its capital in the days of its infancy a sum, nominally interest, but in its real nature a preferred dividend, equal to the amount of interest at the stipu-

¹ *Burt v. Rattle*, 31 Ohio St. 116. Said the court (p. 130): "A mortgage creditor, although denominated a 'preferred stockholder' is a mortgage creditor nevertheless; his interest is not changed into a 'dividend' by calling it a dividend. Nothing is more common in the construction of statutes and contracts than for the court to correct such self-evident misnomers by supplying the proper words."

Cf. *Totten & Co. v. Tison*, 54 Ga. 139; *Savannah, etc. Bldg. Co. v. Silverberg*, 108 Ga. 281; 33 S. E. 908; *Cook v. Equitable Bldg., etc. Ass'n*, 104 Ga. 814, 828-829; 30 S. E. 911.

² *Pittsburgh, etc. R. R. Co. v. County of Allegheny*, 63 Pa. St. 126, 136.

But see *Milwaukee, etc. R. R. Co. v. Field*, 12 Wisc. 340; *Miller v. Pittsburgh, etc. R. R. Co.*, 40 Pa. St. 237; 80 Am. Dec. 570; *M'Laughlin v. Detroit, etc. Ry. Co.*, 8 Mich. 100. See also *infra*, § 1340.

³ *Pittsburgh, etc. R. R. Co. v. County of Allegheny*, 63 Pa. St. 126, 137; *Manice v. Hudson River R. R. Co.*, 3 Duer (N. Y.) 426. Cf. Companies Act, 1907 (7 Edw. VII., c. 50), § 9.

lated rate on the sums respectively paid in by them, before devoting the earnings to dividends to other shareholders or to any other purpose.¹

§ 549-§ 571. EXTENT OF PREFERENTIAL RIGHTS AS BETWEEN
PREFERRED AND DEFERRED SHAREHOLDERS.

§ 549. **How Extent of Preference determined.** — Preferred shares properly so called carry preferential rights over the other shares, but as to all non-members of the company, such as creditors, rank in all respects as any ordinary shares. The preference concerns the shareholders *inter sese*, but in no way affects anybody else. A very great variety of such preferences of one class of shareholders over another is possible. The extent and character of the preference is not indicated by the designation of the shares as "preferred" (which merely indicates that a preference of some kind is intended),² but must be determined by construction of the statute, incorporation paper, by-law,³ or agreement by which the preference is created. The language of the preferred shareholder's share-certificate is not conclusive as to his rights; but the antecedent resolutions and proceedings are admissible evidence upon the question of the nature and extent of his preference.⁴ So, too, where the preference is given in a scheme of reorganization, the court, in order to determine the extent of the preference, will look not merely at the formal agreement, but also at the original plan of reorganization and at the certificates of stock, all the instruments being part of one transaction;⁵ but, unless for the purpose of connecting to-

¹ *Wright v. Vermont, etc. R. R. Ry. Co.*, 84 N. Y. 157, 171-173; *Corp.*, 12 Cush. (Mass.) 68; *Waterman v. Troy, etc. R. R. Co.*, 8 Gray 475, 498-499; 49 Atl. 327. (Mass.) 433.

Cf. *Bates v. Androscoggin, etc. R.*

Cf. *Barnard v. Vermont, etc. R. R. R. Co.*, 49 Me. 491; *Bailey v. Railroad Co.*, 17 Wall. 96.

v. Vermont, etc. R. R. Co., 44 Vt. 613. But see *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 68-69 (where the court held that a preferred shareholder's right was determined by his certificate and refused to look at a prior resolution of the company not referred to in the certificate).

² *Hackett v. Northern Pac. Ry. Co.*, 140 Fed. 717.

³ *Belfast, etc. R. R. Co. v. Belfast*, 77 Me. 445; 1 Atl. 362.

⁵ *Bailey v. Railroad Co.*, 17 Wall. 96 (headnote inadequate).

⁴ *Boardman v. Lake Shore, etc.*

gether the various written instruments, parol evidence of the understanding or intention of the parties is not admissible.¹

As already mentioned,² the general principle, in the light of which every provision for a preference must be construed, is that, except so far as otherwise clearly provided, the preferred shareholders stand on an equality with the common or deferred shareholders. The burden of proof, so to speak, is on the shareholder who asserts a preference over his fellows.

§ 550-§ 563. *Preference as to Dividends.*

§ 550. **What Words will confer Preference as to Dividends.** — A fixed dividend that is guaranteed is a preferred dividend although not expressed so to be.³ Moreover, where shares are denominated “preferred stock” and are entitled “to the payment of six dollars per share semi-annually” the holders are entitled to a preference over the other stockholders although it is not expressly provided that their six per cent dividend shall be paid before any dividend is paid on the other shares.⁴

§ 551. **Whether Preference is Cumulative.** — The first question usually raised as to the preferential dividend is whether the preference is cumulative or not. That is to say, when preferred shares carry a preferential dividend of a certain rate per cent *per annum*, are they entitled to claim that if the profits of one year are not sufficient to pay that dividend in full the deficiency must be made good out of the profits of the next or some succeeding year before anything can be paid to the holders of the common shares? If so, the preferred shares are said to be cumulative preferred shares; if not, they are said to be non-cumulative. *Prima facie*, the preference is cumulative. Thus, where preferred shares are entitled to a preferential yearly dividend of so much per cent, without more being said, the preference is cumulative;⁵ and this is true whether the preferential dividend is

¹ *Bailey v. Railroad Co.*, 17 Wall. Co., 1 De G. & J. 606; *Webb v. Earle*, 20 Eq. 556; *West Chester, etc. R. R. Co. v. Jackson*, 77 Pa. St. 321

² *Supra*, § 540.

³ *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157, 173-174 (headnote inadequate). (headnote misleading); *Smith v. Cork, etc. Ry. Co.*, 3 Ir. Rep. Eq. 356, affirmed, 5 Ir. Rep. Eq. 65; *Fidelity Trust Co. v. Lehigh Valley R. R. Co.* (Pa.), 64 Atl. 829.

⁴ *Bates v. Androscoggin, etc. R. R. Co.*, 49 Me. 491.

⁵ *Henry v. Great Northern Ry.* Cf. *Crawford v. Northeastern Ry.*

described as merely "preferred" or as "guaranteed."¹ Indeed, where a dividend of so much per cent per annum is "guaranteed," it is a cumulative preferential dividend although no preference be expressly provided for.² On the other hand, where no annual preferential dividend is provided for, but where the provision is merely that the preferred shareholders shall be entitled to a dividend *not to exceed* so much *per annum*, the preference is non-cumulative.³ The mere fact that the fixed annual preferential dividend is expressed to be payable on certain days — as on the first days of June and December — will not render the preference non-cumulative, especially where the dividend is guaranteed;⁴ but where the provision is that the preferred shareholders shall be entitled to a preference dividend of so much per cent "out of the profits of each year," an intention is evinced to let each year stand on its own bottom, and accordingly the preference is non-cumulative.⁵ A provision that the annual preferential dividends shall accumulate during the period of three years to the extent they are not paid, entitles the preferred shareholders to an amount equal to three annual preferential dividends before any dividends are paid on the deferred shares even though no dividends at all were paid until long after the expiration of the three years.⁶

§ 552. **Effect of cumulative Preference — Whether Interest is claimable on Arrearages of cumulative preferred Dividends.** — Even where the preferential dividend is cumulative, there is ordinarily no right to interest on the arrearages, or passed dividends;⁷ but where profits properly available for the payment of the preferential dividends were wrongfully diverted by the company to the payment of dividends on the common shares, the preferred shareholders may recover interest on their unpaid

Co., 3 Jur. N. S. 1093; *Matthews v. Co.*, 84 N. Y. 157, 176 (the preferential dividend was "guaranteed").
Great Northern Ry. Co., 28 L. J. Ch. 375.

¹ *Corry v. Londonderry, etc. Ry. Co.*, 29 Beav. 263.

² *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157, 173–174 (headnote inadequate).

³ *Elkins v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 233 (headnote misleading).

⁴ *Boardman v. Lake Shore, etc. Ry.*

⁵ *Staples v. Eastman's Photographic, etc. Co.* (1896), 2 Ch. 303.

See also *Belfast, etc. R. R. Co. v. Belfast*, 77 Me. 445; 1 Atl. 362.

⁶ *Gardner Savings Bank v. Taber-Prang Art Co.*, 189 Mass. 363; 75 N. E. 705.

⁷ *Corry v. Londonderry, etc. Ry. Co.*, 29 Beav. 263.

dividends as damages for the company's wrongful use of the funds.¹

§ 553. *Whether Payments to Preferred Shareholders in Excess of Cumulative Preferred Dividends in one year chargeable against Deficiency in subsequent Year.* — Where the preference is cumulative and the preferred shareholders are entitled to share *pro rata* in any excess of dividends after the deferred shareholders have received a dividend at the same rate as the preferential dividends, dividends paid to the preferred shareholders in excess of the preferential dividend in one year cannot be charged against a deficiency in a subsequent year, but the amount of such deficiency must accumulate and be paid out of the earnings of future years before any further dividends are paid on the deferred shares, just as if the preferred shareholders had never been paid in any year prior to the beginning of the deficit more than their preferential dividend.²

§ 554. *Whether Profits in Excess of Preferential Dividend are divisible pro rata among both Preferred and Common Shareholders.* — The contention has been advanced that where a fixed preferential dividend is payable on preferred shares, the holders are likewise entitled, if the profits are more than sufficient to pay that dividend, to participate rateably with the common shares in any other dividend that may be declared. This contention, however, is on its face unreasonable, and has been overruled by the courts;³ for the principle that should furnish a guide in all such questions as to the extent of preferential rights is that, equality between the shares being the legal conception of equity, provisions altering the rule of equality must be construed strictly, so as not unduly to enlarge the difference in the rights attaching to the several classes of shares.

§ 555. *Whether Preferred Shares may participate in Profits remaining after paying on both Classes of Shares a Dividend equal to the Preferred Dividend.* — When the preferred shares are entitled to a preferential dividend of so much per cent *per annum*, without any greater explicitness being used, a serious question

¹ *Boardman v. Lake Shore, etc.*

Ry. Co., 84 N. Y. 157, 186-190; Md. 475; 49 Atl. 327.

Prouty v. Michigan, etc. R. R. Co., 1 Hun (N. Y.) 655, 667.

² *Scott v. B. & O. R. R. Co.*, 93

Cf. *Bailey v. Railroad Co.*, 17 Wall. 96.

³ *Fidelity Trust Co. v. Lehigh Valley R. R. Co.* (Pa.), 64 Atl. 829.

may be raised whether they are forever limited to that dividend or whether they may not participate proportionately with the common shares in any surplus profits remaining for distribution after paying the common shares a dividend equivalent to the preferential dividend. In a Maryland case,¹ upon the reorganization of the Baltimore and Ohio Railroad Company preferred shares were issued which were entitled to receive out of the net profits of each year such yearly dividend (non-cumulative) as the directors might declare up to but not exceeding four per cent before any dividends should be set apart or paid on the common stock. For several years, the four per cent dividend was regularly paid to the holders of preferred shares, but no dividend was paid upon the common stock. The company then became more prosperous, and was about to pay a dividend of four per cent upon both classes of shares, when a preferred stockholder applied for an injunction against such distribution, praying a declaration that any profits remaining after the payment of the preferential dividend ought to be distributed *pro rata* among both classes of shares, or that any surplus after paying four per cent to common as well as preferred stockholders should be distributed *pro rata*. The former contention sought to exaggerate the preference of the preferred shares to a preposterous degree, and as stated above certainly could not be sustained.² Its rejection was sufficient to justify a refusal of the injunction, since there was no pretense that the company expected at that time to pay more than four per cent to the holders of common stock. The court, however, proceeded to express the opinion that under no circumstances could the preferred shareholders get more than four per cent. This opinion, however, may well be questioned. For if it be sound, the common shares have one very important preference over the so-called preferred shares, although the language used nowhere exhibited any intention to prefer the common shares in any respect whatsoever. The whole object was to define the limits of a preference to be given to the preferred shares. Accordingly, where the provision was that the preferred shares "should bear a dividend of six per cent per annum and should rank in all respects in priority" to the other shares, an English judge expressed the opinion that the meaning was "to give to the

¹ *Scott v. B. & O. R. R. Co.*, 93 Md. 475; 49 Atl. 327. ² *Supra*, § 554.

holders of the preference shares a first dividend at the rate of six per cent out of profits, then to give the holders of ordinary shares a dividend up to the amount of 6 per cent out of profits, and if any profits should remain after paying those two dividends to allow the ordinary and preferential shareholders to divide them equally or proportionately.”¹ It is submitted that this is the better general rule, and that the case in the Maryland Court of Appeals, if it is to be regarded as more than a mere dictum upon this question, should be supported upon the special circumstances adverted to by that court in its opinion.

§ 556. *Rights where both Classes of shares are to participate equally in Profits remaining after paying on both Classes of Shares Dividends equal to the preferred Dividend.* — At any rate, cases sometimes occur where, either by express provision or by judicial construction of an ambiguous provision, both classes of shares are entitled to participate equally in any profits that may remain for distribution after the common shares have received a dividend equal to the preferential dividend of the preferred shares. Where this is the case, if the preferred shares are cumulative, they cannot claim anything beyond their preferential dividend until the common shareholders have not merely received a dividend for the current year equivalent to the preferential dividend but also have been compensated for all arrears or passed dividends, so that taking into consideration the entire period since the issue of the shares, each common shareholder shall have received as much as each preferred shareholder.² If the preferred shares were non-cumulative, it might be plausibly argued that an intent was evinced that each year should stand on its own bottom. But, nevertheless, the sound doctrine is believed to be that unless a different intention is very clearly expressed the common shareholders must be placed on an equality with the preferred as to the whole period since the issue of the stock, whether the preferred shares be cumulative or not, before any *pro rata* division among both classes is proper. Whether the

¹ *Alexandra Palace Co.*, 21 Ch. Co., 25 W. R. 524. But see contra: *D. 149, 157*. The terms of the resolution defining the rights of the preferred shares appear more clearly from the report of the case in 46 L. T. 730. *Gordon's Exrs. v. Richmond, etc. R. Co.*, 78 Va. 501, 518. Cf. *Fidelity Trust Co. v. Lehigh Valley R. R. Co.* (Pa.), 64 Atl. 829 (stated *supra*, § 553).

² *Allen v. Londonderry, etc. Ry.*

preference be cumulative or not, each ordinary share must receive as much as each preferred share has actually received when the whole period since the issue of the stock is taken into account, before the two classes of shares can be deemed to have been put upon an equality.

§ 557. **How Preferential Dividend payable — Gold, Cash, Bonds, etc.** — Where dividends are paid in bonds or other obligations of the company, as may sometimes lawfully be done, the rights of the preferred shareholders to a preference are of course the same as if the dividends were paid in cash.¹ In the absence of some peculiar stipulation, however, or consent, preferred shareholders have the right to insist that their preferential dividend be paid in cash and not in bonds or other securities;² but the common or deferred shareholders cannot, it seems, object to paying the preferential dividend in stock rather than in money.³ There may be an express stipulation that the preferred dividend shall be payable in gold, but in the absence of such a provision payment may be made in any legal tender.⁴

§ 558. **Provisions for Termination of Preference.** — Where preferred shares are entitled "to the payment of six dollars per share semi-annually until the net earnings of the road shall be sufficient to pay an interest of six per cent per annum on all the stock issued," it seems that when once the earnings of the road are sufficient for one whole year to pay a dividend of six per centum on all the stock, the preferred shareholders would thereafter have no rights superior to the holders of the other shares;⁵ but the fact that for six months or any other fraction of a year the profits may have been sufficient to pay a dividend on all the shares at the rate of six per cent per annum does not put an end to the preference.⁶

§ 559. **Effect of Cancellation or Surrender of some of the Preferred Shares.** — Where some of the preferred shares are cancelled or exchanged for common shares, the holders of the re-

¹ *Gordon's Exrs. v. Richmond, etc. R. R. Co.*, 78 Va. 501. Cf. *Howell v. Chicago, etc. Ry. Co.*, 51 Barb. (N. Y.) 378.

See also *infra*, § 568.

² *M'Laughlin v. Detroit, etc. Ry. Co.*, 8 Mich. 100.

³ *Howell v. Chicago, etc. Ry. Co.*, 51 Barb. (N. Y.) 378.

⁴ *Baltimore, etc. R. R. Co. v. State*, 36 Md. 519.

⁵ *Bates v. Androscoggin, etc. R.*

R. Co., 49 Me. 491, 503 (semble).

⁶ *Bates v. Androscoggin, etc. R. Co.*, 49 Me. 491.

maining preferred shares are entitled to all the subsequent profits until their preferential dividends are paid, and not merely to the proportion of such profits which they would have received if the holders of the cancelled or exchanged shares had retained their rights.¹

§ 560. **Discretion of Company as to withholding Preferred Dividends although earned.** — In general, the holders of preferred shares cannot require payment of their preferential dividend, even if the funds available for that purpose have been earned, unless the dividend has been declared in the ordinary way by the directors of the corporation. That is to say, the preference given to the preferred shareholders is between themselves and the other shareholders, and does not deprive the company of its discretion to accumulate profits, as a reserve fund, to make good a loss of fixed capital, or for other purposes, instead of distributing them as dividends. Hence, although profits sufficient to pay the preferential dividend may have been earned, the directors may ordinarily withhold declaration of the preferred dividend if so to do is honestly and reasonably believed by them to be for the best interest of all concerned in the company,² and this is true although the preferred dividend is “guaranteed” by the company.³ A provision that the preferential dividend shall be dependent on the profits of each particular year will not be construed as pledging the profits to such payment so as to deprive the directors of their discretion to use them in the

¹ *West Chester, etc. R. R. Co. v. Co.*, 7 Allen (Mass.) 512 (headnote inadequate).
Jackson, 77 Pa. St. 321, 328 (headnote misleading).

² *Bond v. Barrow Hæmatite Steel Co.* (1902), 1 Ch. 353; *New York, etc. R. R. Co. v. Nickals*, 119 U. S. 296; 7 Sup. Ct. 209 (where the directors devoted net earnings to the building of a double track, erection of buildings, construction of docks, and other improvements, instead of paying the preferred dividend); *McLean v. Pittsburgh Plate Glass Co.*, 159 Pa. 112; 28 Atl. 211.

Cf. *Hazeltine v. Belfast, etc. R. R. Co.*, 79 Me. 411; 10 Atl. 328; 1 Am. St. Rep. 330; *Storrow v. Texas, etc. Mfg. Ass'n*, 87 Fed. 612; 31 C. C. A. 139; *Barnard v. Vermont, etc. R. R. Co.*, 7 Allen (Mass.) 512.

But see *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 598-601 (where the court held, among other things, that as between preferred and common shareholders the expense of permanent betterments should not be paid out of earnings, with the result of diminishing the preferred dividends). Cf. *Seattle Trust Co. v. Pitner*, 18 Wash. 401; 51 Pac. 1048; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516; 76 N. E. 707.

³ *Field v. Lamson, etc. Mfg. Co.*, 162 Mass. 388; 38 N. E. 1126; 27 L. R. A. 136.

Cf. *Barnard v. Vermont, etc. R. R. Co.*, 7 Allen (Mass.) 512.

business of the company.¹ Similarly, a clause in an incorporation paper which provides that as between the holders of the different classes of shares, "the profits available for dividend shall be applicable as follows: (1) to the payment of a non-cumulative preferential dividend" with further provisions as to the distribution of any excess, does not override a clause in the contemporaneous articles of association which purports to authorize the directors to accumulate profits as a reserve fund, so that the directors may in good faith accumulate a reserve before paying the preferential dividend in full.² So, too, a provision that the second preferred shares shall be entitled to their preferential dividend "only after payment" of interest on the bonded debt and of the preferential dividend on the first preferred shares does not preclude the company from accumulating profits as a surplus or reserve fund.³ Indeed, where the company has a license to use a patent in consideration of a royalty amounting to a certain proportion of the annual "profits available for dividend," it was held that the company might deduct each year a certain sum for depreciation in the value of the license before determining the amount of "profits available for dividend" within the meaning of the contract, although the company could not have been enjoined from paying dividends without making any such deduction for depreciation.⁴

§ 561. **Remedies of Preferred Shareholders for arbitrary Withholding of Preferential Dividend.**— But if the company's refusal to declare the preferred dividend is arbitrary and oppressive and contrary to the terms on which the preferred shares were issued, a court of equity will overrule their determination and compel the declaration of a dividend;⁵ and this is espe-

¹ *New York, etc. R. R. Co. v. Nickals*, 119 U. S. 296; 7 Sup. Ct. 1 Ch. 146 (with which compare *infra*, § 1326).

209. But see *Dent v. London Tramways Co.*, 16 Ch. D. 344.

² *Fisher v. Black & White Pub. Co.* (1901), 1 Ch. 174. Cf. *Wemyss Collieries Trust v. Melville*, 8 Fraser (Sc.) 143 (to substantially the same effect).

³ *Bond v. Barrow Hæmatite Steel Co.* (1902), 1 Ch. 353, 363 (headnote inadequate).

⁴ *Bagot Pneumatic Tyre Co. v. Clipper Pneumatic Tyre Co.* (1902),

⁵ *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157, 179-180.

Cf. *Richardson v. Vermont, etc. R. R. Co.*, 44 Vt. 613; *Barnard v. Vermont, etc. R. R. Co.*, 7 Allen (Mass.) 512; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516; 76 N. E. 707.

As to whether the directors and officers are proper parties defendant to such a suit, see *Chase v. Vanderbilt*, 62 N. Y. 307.

cially true where the preferential dividend is non-cumulative, so that, if once passed, it is gone forever,¹ or where the preferred shareholders have no vote in the management of the corporation and therefore no voice in determining whether dividends should be declared.² The remedy of the preferred shareholders in such cases, however, even when the preferential dividend is "guaranteed" is exclusively in equity and not at law.³ In order that sufficient profits to justify and require the payment of the preferred dividend should be in hand, it is not necessary that the available earnings should be sufficient to pay the dividend on the total authorized number of preferred shares but only on the number actually issued.⁴ The wrongful withholding of preferential dividends is certainly not sufficient cause for appointing a receiver to manage the business of the company.⁵

Where the certificate of the cumulative preferred shares is under the corporate seal, it has been held that the statute of limitations will not bar the claim of the preferred shareholders to arrears of dividends until the lapse of the period of limitations applicable to actions on contracts under seal.⁶

§ 562. **Remedies against Payment to Deferred Shareholders in fraud of Preferential Rights.** — It is very clear that a court of equity will enjoin the corporation from paying dividends to the ordinary or common shareholders in fraud of the preferential

¹ *Belfast, etc. R. R. Co. v. Belfast, Co. v. Jackson*, 77 Pa. St. 321; *Bates* 77 Me. 445; 1 Atl. 362; *Hazeltine v. v. Androscoggin, etc. R. R. Co.*, 49 *Belfast, etc. R. R. Co.*, 79 Me. 411; Me. 491.
10 Atl. 328; 1 Am. St. Rep. 330.

Cf. *Nickals v. N. Y., etc. Ry. Co.*, 15 Fed. 575 (reversed, 119 U. S. 296).

Quare, whether the directors may accumulate a reserve "for the purpose of equalizing dividends." *Fisher v. Black & White Pub. Co.* (1901), 1 Ch. 174.

² *Storrow v. Texas, etc. Mfg. Ass'n*, 87 Fed. 612; 31 C. C. A. 139.

³ *Field v. Lamson, etc. Mfg. Co.*, 162 Mass. 388; 38 N. E. 1126; 27 L. R. A. 136; *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157, 179; *Williston v. Michigan, etc. R. R. Co.*, 13 Allen (Mass.) 400.

But see *West Chester, etc. R. R.*

Cf. *M'Laughlin v. Detroit, etc. Ry. Co.*, 8 Mich. 100; *Richardson v. Vermont, etc. R. R. Co.*, 44 Vt. 613; *Cratty v. Peoria Law Library Ass'n*, 219 Ill. 516; 76 N. E. 707 (overruling an objection in a suit in equity that complaining preferred shareholders had adequate remedy at law).

⁴ *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582, 610.

⁵ *Texas Consol., etc. Ass'n v. Storrow*, 92 Fed. 5, 10-12; 34 C. C. A. 182.

⁶ *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 75-76.

Cf. *infra*, § 1360.

rights of the preferred shareholders.¹ A bill for this purpose may be filed by one of the preferred shareholders on behalf of all, notwithstanding a dispute has arisen between transferors and transferees of some of the other preferred shares as to their relative rights to arrears of dividends.² The complainant may represent both transferors and transferees for the purpose of the suit. It is sufficient to make one or more of the common or deferred shareholders parties defendant as representatives of all of their class.³ The effect of laches of preferred shareholders in enforcing their rights to prevent payments to the common or deferred shareholders has been discussed in several cases.⁴ In one case where the holders of cumulative preferred shares had omitted to oppose the payment of dividends to the ordinary shareholders before making good the arrearages of the preferential dividends, Lord Hatherley held that while perhaps this acquiescence barred the preferred shareholders from calling back the dividends which had been already paid to the ordinary shareholders, it did not prevent them from enjoining the payment of further dividends to the ordinary shareholders before making good the arrears of the preferential dividend.⁵

§ 563. **When Deferred Shareholders may compel Declaration of Preferential Dividend.** — In general, the deferred or common shareholders would have no interest to compel the declaration of the preferred dividend; but sometimes the preference is to continue only for a period of years until a certain number of the preferential dividends have been paid, and in such cases the common shareholders would have the same right to compel declaration of a dividend for payment of which sufficient profits have been earned as a preferred non-cumulative shareholder would have. Thus, when subscribers to common stock are not to be regarded as shareholders or entitled to any voice in the

¹ *Boardman v. Lake Shore, etc.* Hun (N. Y.) 655, 666; *Elkins v. Ry. Co.*, 84 N. Y. 157; *Smith v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 233, 239-240.

² *Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 233, 239-240.

³ *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 77-78.

⁴ *Smith v. Cork, etc. Ry. Co.*, 5 Ir. Rep. Eq. 65, 78-79.

⁵ See *Boardman v. Lake Shore, etc. Ry. Co.*, 84 N. Y. 157, 182-184; *Prouty v. Michigan, etc. R. R. Co.*, 1

⁶ *Matthews v. Great Northern Ry. Co.*, 28 L. J. Ch. 375, 382-383.

Cf. *Elkins v. Camden, etc. R. R. Co.*, 36 N. J. Eq. 233 (headnote misleading); *Smith v. Cork, etc. Ry. Co.*,

management of the company until five successive annual dividends shall have been paid to the preferred shareholders, the court will treat that as done which ought to have been done, and, where amply sufficient profits have been earned for the payment of the five annual seven per cent dividends, although such dividends were not actually declared or paid, will compel the company to admit the subscribers to common stock to all the rights of ordinary shareholders, at the same time decreeing that an amount equal to the preferential dividends that ought to have been paid be distributed to the preferred shareholders.¹

§ 564-§ 568. *Preference as to Repayment of Capital in Liquidation.*

§ 564. **Legality of such a Preference.** — Where a corporation has power to issue shares with such preference as it may determine, it may issue shares which shall have a preference with respect to repayment of capital in liquidation as well as with respect to dividends.² Indeed, the matter of the relative rights of shareholders in assets remaining after payment of all creditors in liquidation or winding-up is, like the subject of the distribution of profits available for dividends, a mere matter for their private concern, and hence by agreement among themselves, without any affirmative authorization, they may provide that preferred shares shall be entitled to a preference in respect of capital.³ It is competent for the company in issuing preferred shares to provide that the holders of such shares shall in the event of liquidation not merely receive back the nominal value of the shares before any capital is returned to the other shareholders, but shall also be entitled to a premium or bonus in addition thereto.⁴

§ 565. **When Preference as to Capital exists and when not.** — The law is well settled that a preference as to dividends does not carry by implication any preference as to capital in a dis-

¹ *Mackintosh v. Flint, etc. R. R. Co.*, 34 Fed. 582.

² *Supra*, § 531.

³ *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 531; 36 C. C. A. 155.

⁴ *Cf. South African Supply, etc. Co.* (1904), 2 Ch. 268 (where the preferred shareholders were entitled to a premium or bonus in the event of winding-up for the purpose of reconstruction or amalgamation).

tribution of assets in winding-up.¹ Priority, in respect to capital, therefore, if it is to be conferred upon the preferred shares, must generally be given by appropriate language.² Even overdue cumulative preferential dividends are not a charge upon capital in proceedings for reduction of capital or for liquidation of the company.³ Where, however, the general incorporation law of the state provides that preferred shares in companies organized thereunder shall have a preference in respect of capital, the court will presume that preferred shares issued by a company incorporated by special act were intended, in the absence of any circumstances indicative of contrary intent, to have a like preference;⁴ and so where a general incorporation law provides that upon dissolution the assets shall be distributed among the common shareholders after payment of creditors and the preferred shareholders, and also contains a further provision that any incorporation paper may create two or more kinds of shares with such preferences or restrictions as may be fixed in the incorporation paper, shares which by the incorporation paper are declared to have a preference as to dividends will also have a preference as to capital unless the contrary be provided by the incorporation paper.⁵ A provision that preferred shares shall be a lien subject only to an existing issue of mortgage bonds gives the preferred shares a preference over the common in respect to capital as well as dividends.⁶

¹ *London India Rubber Co.*, 5 Eq. 519; *Griffith v. Paget*, 6 Ch. D. 511; *North West Argentine Ry. Co.* (1900), 2 Ch. 882 (where the point was apparently treated as too clear for argument); *Odessa Waterworks Co.*, W. N. (1897) 166; *Jones v. Concord & Montreal R. R. Co.*, 67 N. H. 119 (semble); 38 Atl. 120; *Jones v. Concord & Montreal R. R. Co.*, 67 N. H. 234; 30 Atl. 614; 68 Am. St. Rep. 650 (semble).

Cf. *McGregor v. Home Ins. Co.*, 33 N. J. Eq. 181. By parity of reasoning, an agreement that a public service company's business shall be carried on with only such charges or tolls as may be necessary to defray expenses, does not destroy the ultimate right of the shareholders in

the assets in case of dissolution. *Consumers' Gas Trust v. Quinby*, 137 Fed. 882; 70 C. C. A. 220.

² As to what language will be sufficient to confer a preference as to capital, see in addition to cases cited below *Bangor Slate Co.*, 20 Eq. 59 (stated supra, § 532).

³ *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257; 77 N. E. 13; 112 Am. St. Rep. 607.

⁴ *McGregor v. Home Ins. Co.*, 33 N. J. Eq. 181.

⁵ *Hellman v. Pennsylvania Electric Vehicle Co.* (N. J.), 67 Atl. 834.

⁶ *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664, 670; 24 C. C. A. 271; 36 L. R. A. 826; *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497, 529-531, 36 C. C. A. 155.

§ 566. **Attempts to confer indirectly a Preference as to Capital upon Shares not entitled thereto.** — Where preferred shares have no preference as respects capital, they must in a winding-up, which is in theory a return of capital, receive no more than the common shareholders receive. This rule cannot be evaded by any scheme of reconstruction or reorganization. Thus, where preferred shares have no preference as regards capital, a scheme of reconstruction under the English Companies Act which provides that the preferred shareholders in the company being wound up shall receive in exchange preferred shares in a new corporation formed to take over the assets and business of the old company, while the ordinary shareholders in the old company shall receive ordinary shares in the new, gives the preferred shareholders more than the ordinary shareholders, and is therefore *ultra vires*.¹ On the other hand, where a statute authorized the consolidation of two railway companies upon such terms and conditions as might be approved by a majority of both companies, a scheme for amalgamation whereby the preferred shareholders of one of the old corporations, although entitled to no preference as respects capital, received for every four shares of their old stock five shares in the new company while the common stockholders only received for every two shares of their old stock one share in the new company, was held to be *intra vires*.²

§ 567. **What Funds regarded as Capital and what as Profits in Liquidation.** — Where the preferred shares are entitled to a preference as to dividends but not as to capital, it is important to inquire, when the corporation goes into liquidation, what property or funds can be regarded as capital divisible *pro rata* among holders of both classes of shares and what as profits subject to the preferential claim of the preferred shareholders. To the extent necessary to repay the several shareholders the amount nominally paid upon their respective shares, it seems clear that any funds of the corporation, whether due to earnings or to any other source, must in winding-up or liquidation be regarded as capital as between the preferred and common or ordinary shareholders. Indeed, as a general rule any surplus funds over and above the amount necessary to repay the several shareholders

¹ *Simpson v. Palace Theatre*, 69 L. T., N. S., 70.

² *Hale v. Cheshire R. R. Co.*, 161 Mass. 443; 37 N. E. 307.

the paid-up capital must also, in winding-up or liquidation, be treated as capital as between the preferred and deferred shareholders. Thus, the House of Lords has held that where, in a winding-up, the company's business or "undertaking" is sold, the residue of the purchase price remaining after paying off all liabilities and returning all paid-up capital is, as between preferred and deferred shareholders, to be treated as capital and not profits.¹ The company having ceased to be a going concern, the discretion of the directors, or of the corporation, to treat an appreciation of assets in excess of the nominal capital as profits available for dividends had terminated. It was once held that profits accumulated as a reserve fund should, upon the voluntary winding-up of the company, be treated as still profits and not capital.² By the later decisions this rule has been qualified, if not overthrown; and it is now held that where the company has a discretionary power of reserving profits before paying the preferential dividend to preferred shareholders, if the company goes into liquidation before this discretion is exercised or the preferred dividend declared out of profits earned shortly before the liquidation, the profits so earned should be regarded as capital as between the preferred and ordinary shares, and as such distributed *pro rata* among both the classes of shareholders.³ The question here, as in the similar case where the rights of tenants for life and remaindermen are involved,⁴ is whether accumulated profits are, in liquidation or winding-up, regarded as capital unless they have been declared as dividends

¹ *Birch v. Cropper*, 14 App. Cas. 525.

Cf. *Frames v. Bultfontein Mining Co.* (1891), 1 Ch. 140; *Morrow v. Peterborough Water Co.*, 4 Ont. L. R. 324 (where the company's regulations provided that in liquidation after repaying to the preferred shareholders the capital contributed by them, the amount remaining should be distributed among ordinary shareholders, and were enforced accordingly).

² *Bridgewater Navigation Co.* (1891), 2 Ch. 317; *Bishop v. Smyrna & Cassaba Ry.* (1895), 2 Ch. 265.

³ *Crichton's Oil Co.* (1902), 2 Ch.

86; *Odessa Waterworks Co.* (1901), 2 Ch. 190 n.

But see *Re Rogers*, 161 N. Y. 108, 113; 55 N. E. 393, where the court said, "After effecting a sale of the company's plant it ceased to do business and went into liquidation. After such sale it could no longer earn profits for distribution, and the directors were no longer vested with any discretion with reference to the conduct of the business or judgment as to the amount of profits to be retained and employed as a working capital."

⁴ See *infra*, § 1394.

or are regarded as profits unless they have been capitalized by proceedings for the increase of capital. Even, however, when the company is in liquidation, it has been held that a fund due to the appreciation of certain bonds held by the company will, as between preferred and ordinary shareholders and for the benefit of the former, be treated as profits where a previous depreciation of the same bonds has been debited to the revenue account to the prejudice of the preferred shareholders;¹ but this decision is not easy to reconcile with the principles acted upon in the later cases above cited.

It seems that moneys earned after the commencement of liquidation proceedings should be treated as capital.²

§ 568. **Whether Preferred Shareholders are entitled in Liquidation to "Interest" from the Time of Cessation of Business in lieu of Preferential Dividend.** — As the preferential dividends are payable only out of profits it follows that if the company ceases to do business, with a view to winding-up, the preferential dividend ceases to be payable even though the preferred shareholders be entitled to a preference as to capital as well as dividends. For example, if the company goes into liquidation any balance which may remain after satisfying all claims of creditors should be used for the purpose of returning capital to the several shareholders according to their respective rights; and no part should be devoted to paying to the preferred shareholders "interest" on their shares from the date of the last payment of the preferential dividend, to the prejudice of the claim of the common or deferred shareholders for the return of the capital invested by them.³

§ 569. **Preference as to Distribution of New Shares upon an Increase of Capital.** — Upon the principle that preferred shareholders stand on equality with the ordinary shareholders except in so far as their preferential rights expressly or by necessary implication carry, a preference in respect to dividends does not confer a preference in respect to the distribution of new shares

¹ *Bishop v. Smyrna & Cassaba* (where counsel conceded the point).
Ry. Co., No. 2 (1895), 2 Ch. 596.

² *Bishop v. Smyrna & Cassaba* ³ *Wilson v. Parvin*, 119 Fed. 652;
Ry. Co., No. 2 (1895), 2 Ch. 596 56 C. C. A. 268.

upon an increase of capital; and accordingly upon such an increase both common and preferred shareholders have the same option of subscribing to the new shares before any of them are offered for subscription to non-members of the company.¹ In one case, the payment of a "stock dividend" payable to preferred shareholders in preferred stock and to common shareholders in common stock was held to be, under the circumstances, no violation of the rights of the common shareholders.²

§ 570. **Preference as to Voting Rights.**—Inasmuch as preferred shareholders are members of the company, and, except in so far as their rights may be altered by the contract, statute, or by-law under which the shares are issued, entitled in all respects to the same rights as other shareholders, it follows that they have the same voting rights as other shareholders. The right of shareholders to vote is, however, like the right to dividends or to participate equally in a division of capital on liquidation, regarded as a private matter for each shareholder which he may waive if he choose. Consequently, a provision that shareholders of a certain class shall have no right to vote is, if assented to by them, quite valid.³ Such a provision might theoretically be made as to either the preferred or the deferred shares, but is much more common with respect to the preferred shares so as to compensate the other shareholders for the preference of the preferred shareholders as to dividends. A provision in an incorporation paper, whereby the preferred shareholders shall have no right to vote is, therefore, valid even though a statute provide that every shareholder shall be entitled to one vote for every share held by him.⁴ On the other hand, the Supreme Court of Canada has recently held that where the incorporation law enacts that at an election of directors each shareholder shall have as many votes as he holds shares, a provision in the incorporation paper whereby the holders of certain preferred shares should have the right to choose three of the five directors is

¹ *Jones v. Concord & Montreal R. R. Co.*, 67 N. H. 119; 38 Atl. 120; (Mo.), 89 S. W. 872; 190 Mo. 561.

Jones v. Concord & Montreal R. R. Co., 67 N. H. 234; 30 Atl. 614; 68 Am. St. Rep. 650.

⁴ *State ex rel. Frank v. Swanger* (Mo.), 89 S. W. 872; 190 Mo.

³ *Howell v. Chicago, etc. Ry. Co.*, 51 Barb. (N. Y.) 378.

invalid.¹ It is submitted that this construction of the statute is narrow, and it is encouraging to find that the American court has taken the more liberal view.

§ 571. **Preference as to Liability to Creditors.** — We have seen that in the absence of stipulation to the contrary, preferred shareholders are subject to any statutory liability to creditors that may attach to other members;² and indeed it would not be competent by mere agreement to exempt the preferred shareholders from this liability, except as between them and the ordinary shareholders.

§ 572. **Consequences of Distinction between Preferred and Deferred Shares upon Rules as to Parties in legal Proceedings.** — In consequence of the division of a company's shares into preferred and common or ordinary, a distinction is created between the two classes of shares which may render it proper that in certain suits regarding the corporate affairs representatives of both classes should be made parties. Thus, where the preferred shares are entitled to a preference over the common in respect both to dividends and capital, and do not enjoy the ordinary voting rights, the preferred shareholders are proper to be admitted as parties to consolidated suits for the winding-up of the company and the foreclosure of the mortgage securing its bonds.³ Similarly, as more fully pointed out below, in cases of shareholders' bills, it is sometimes necessary to join as defendant a representative of a class of shareholders whose interests conflict with those of the plaintiff.⁴ Where a representative of some one class of shareholders is desired, an individual should be selected who is not an officer or director in the company; since the duty of officers and directors is to represent all classes of shareholders impartially.⁵ It has been held that the common stockholders, although proper, are not necessary parties to a suit by preferred

¹ *Colonist Printing & Pub. Co., v. Dunsmuir*, 32 Can. Sup. Ct. 679. Cf. *Durkee v. People*, 155 Ill. 354; 40 N. E. 626; 46 Am. St. Rep. 340 (stated *infra*, § 1239).

² *Supra*, § 540.

³ *Hamlin v. Toledo, etc. R. R. Co.*, 78 Fed. 664; 24 C. C. A. 271; 36 L. R. A. 826.

⁴ See *infra*, § 1177.

⁵ *Chase v. Vanderbilt*, 62 N. Y. 307.

stockholders to compel declaration or payment of the preferential dividend.¹

§ 573. **Consequences of Distinction upon Powers of Management of Majority of Company.** — As the interests of preferred and common shareholders often conflict, controversies between them often arise. The rules of law applicable in such cases are the same as apply to other cases in which some shareholders have individual interests in matters of corporate management conflicting with those of the general body of their fellows. That is to say, any class of shareholders are not deprived of their control over the corporate management merely because their interests may not coincide with those of the other class of shareholders.² Thus, a railway company having power to lease its road may against the objection of common shareholders execute a lease for ninety-nine years at a rental which is less than sufficient to pay the preference dividend, and which therefore will exclude the common shareholders from any income throughout the whole long period of the lease.³

¹ *Thompson v. Erie Ry. Co.*, 45 N. Y. 468; *Prouty v. Michigan, etc. R. R. Co.*, 1 Hun (N. Y.) 655.

² But cf. *infra*, § 1397.

³ *Middletown v. Boston, etc. R. R. Co.*, 53 Conn. 351; 5 Atl. 706.

CHAPTER XI

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§ 574 INCREASE AND REDUCTION OF CAPITAL [CHAP. XI]

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§ 574. **Whether Amount of Capital as fixed by Incorporation Paper can be altered.** — The amount of the nominal or share capital of a corporation is usually fixed by the act of incorporation if the company be incorporated by special act, or by the incorporation paper if the company be organized under a general law. Like other provisions of a special act of incorporation or incorporation paper, the provision fixing the amount of the company's capital cannot be changed by the corporation unless some mode of alteration be provided by statute. Hence, where the statute requires the amount of the capital stock to be stated in the incorporation paper, a clause, inserted without statutory authority, purporting to confer upon the company the power to increase or alter the amount of the capital at pleasure is null and void.¹

§ 575. **Whether Amount can be altered when not fixed by Incorporation Paper.** — In comparatively rare cases, incorporation laws provide that the amount of the company's capital shall be fixed by the corporation itself after its organization. In such cases the question arises whether the company, having once fixed the amount of its capital in pursuance of the statute, has any power to alter its determination in that regard. According to

¹ *Grangers' Life and Health Ins. Co. v. Kamper*, 73 Ala. 325. Cf. *Palmer v. Bank of Zumbrota*, 72 Minn. 266, 276-277 (headnote inadequate); 75 N. W. 380; *Dexine Patent Packing & Rubber Co.*, 88 L. T. 791 (holding that where statute allows reduction in pursuance of a provision in the articles or by-laws a clause in the memorandum or incorporation paper cannot authorize a reduction unless the articles or by-laws are first amended so as to provide therefor). As to a provision in an incorporation paper for the simultaneous issue and cancellation of part of the authorized capital, the scheme being adopted as a matter of bookkeeping convenience, see *State v. Consolidated Gas, etc. Co.* (Md.), 65 Atl. 40.

the better view, it would seem that no such power of alteration exists,¹ although some authorities support the contrary view.²

§ 576. **Three Kinds of Alteration of Capital.** — A corporation may desire to alter its capital either (1) by way of increase or (2) by way of decrease or (3) by some change in the number or par value of the shares without either increasing or diminishing the aggregate amount of the capital.

§ 577-§ 619. INCREASE OF CAPITAL.

§ 577. **Definition and Kinds of Increase of Capital.** — First, then, of increase of capital. This may, provided the laws permit, be accomplished either by issuing new shares or by increasing the par value of the old shares. The former is much the more common way of increasing capital, and in the following pages may be taken as referred to whenever the phrase "increase of capital" is used unless that phrase is qualified by an explicit declaration that increase by adding to the par value of the shares is meant.³ An increase of nominal capital may or may not be accompanied by an increase of actual capital. Thus, when a company in pursuance of statutory authority cancels its existing stock and issues to each holder in lieu thereof a larger nominal amount of new stock, although the actual or working capital is not affected, there is clearly an increase of the nominal or share capital, which is taxable as such.⁴ The acquisition of additional property by gift, devise, or in any other way, although it may augment the actual or working capital of the company, does not amount to any increase in its nominal or share capital, and is not to be deemed an

¹ Cf. *Sutherland v. Olcott*, 95 N. Y. 93.

² *Somerset, etc. R. R. Co. v. Cushing*, 45 Me. 524; *Peck v. Elliott*, 79 Fed. 10; 24 C. C. A. 425; 38 L. R. A. 616.

Cf. *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156 (where a company incorporated by a special act which fixed a maximum and minimum capital, having fixed upon

the minimum sum as the capital of the company, afterwards without objection issued new shares up to the maximum amount).

³ As to an illegal attempt to increase the capital by increasing the par value of the shares, see *Tschumi v. Hills*, 6 Kan. App. 549; 51 Pac. 619.

⁴ *Midland Railway Co. v. Attorney-General* (1902), A. C. 171.

increase of capital in the legal sense: the prohibition of unauthorized increase of capital on the part of a corporation does not prevent it from accepting as much property as it can lawfully acquire, even in excess of its nominal capital.¹ Moreover, the acquisition by one corporation of all the shares in another company, thereby accomplishing a virtual consolidation, does not amount to an increase in the capital of the second or subsidiary company either in the technical legal sense or within the meaning of a contract between such subsidiary company and a third person which entitled him to an allotment of forty-eight per cent of any increased capital of said company.²

§ 578. **Effects of Increase upon Creditors and Shareholders.** — An increase of capital in either of the two ways above mentioned works a fundamental change in the constitution of the company. So far as creditors are concerned, the change thus wrought is much less serious than the change effected by a diminution of capital. A creditor is not prejudiced by an increment to the resources of the company and to the fund to which he must look for payment of his claims. Even if the addition to the nominal capital of the company is not accompanied by a corresponding increase in the actual or working capital, nevertheless the existing creditors are no worse off than they were before the change. The only way in which an increase of actual capital can injuriously affect creditors is by tempting the company to use its newly acquired resources in new and speculative enterprises. As respects shareholders, however, the increase of capital may be far more prejudicial. Thus, an increase in the par value of the shares may enlarge the amount of the shareholders' liability to the company or its creditors. If new shares are issued, the proportionate interest of an old shareholder is diminished. For instance, if a man owns forty-eight per cent of the capital stock, he can generally dominate the policy of the company; but if the capital be doubled by the issue of new shares, he will own only twenty-four per cent of the shares, and will therefore be reduced to a comparatively insignificant factor.

¹ *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. 280. See *infra*, *Einstein v. Rochester Gas, etc. Co.*, 146 N. Y. 46; 40 N. E. 631. § 1345.

§ 579-§ 582. *Illegal Increase of Capital.*

§ 579. **Shares in Excess of authorized Capital void.** — As already stated, an increase of capital is unlawful unless some enabling statute exists, the provisions whereof are followed. If a corporation, being wholly without legal power to increase its capital, undertakes to issue shares in excess of its authorized capital, such shares are void and do not confer upon the holders the rights of shareholders¹ nor subject them to the liabilities of shareholders,² even though the holders actively promoted and participated in making the illegal increase;³ and payments made on account of such void shares in the belief that the issue was valid may be recovered back.⁴

The law is the same where the company has power to increase its capital after a certain time, and undertakes to increase it before that time arrives. For instance, if the company has power to increase its capital stock after the original stock shall have been fully allotted and paid in, an increase which the company attempts to make before the original capital has been fully subscribed or paid in has been held to be wholly void, so that the holders of such new stock are not subjected to any liability as stockholders.⁵ The rule is the same where the company having power to increase its capital to a certain amount undertakes to

¹ *People ex rel. Jenkins v. Parker Vein Coal Co.*, 10 How. Pr. (N. Y.) 543. See also *infra*, § 909.

² *Scovill v. Thayer*, 105 U. S. 143, 149 (explaining *Upton v. Trebilcock*, 91 U. S. 45; *Chubb v. Upton*, 95 U. S. 665; *Pullman v. Upton*, 96 U. S. 328); *Page v. Austin*, 10 Can. Sup. Ct. 132; *Clark v. Turner*, 73 Ga. 1; *Lathrop v. Kneeland*, 46 Barb. (N. Y.) 432.

But see *Kansas City Hotel Co. v. Harris*, 51 Mo. 464; *Palmer v. Bank of Zumbrota*, 72 Minn. 266; 75 N. W. 380.

³ *Railroad v. Sneed*, 99 Tenn. 1; 41 S. W. 364; 47 S. W. 89.

But as to the liability of directors for representing to creditors that they have subscribed to valid stock

of the company, see *Dwinnell v. Minneapolis Fire, etc. Ins. Co.*, 97 Minn. 340; 106 N. W. 312.

⁴ *Grangers' Life, etc. Ins. Co. v. Kamper*, 73 Ala. 325 (where it was held that the remedy was at law and not in equity); *Anthony v. Household, etc. Machine Co.*, 16 R. I. 571; 18 Atl. 176; 5 L. R. A. 575 (recovery allowed notwithstanding passage of a statute after the making of the contract authorizing the issue of the new shares).

Cf. *Western Nat. Bank v. Armstrong*, 152 U. S. 346, 353-354; 14 Sup. Ct. 572 (holding that such a claim is not a preferred claim against the receiver of the company).

⁵ *Page v. Austin*, 10 Can. Sup. Ct. 132.

increase it to a greater amount:¹ in such case the new shares will not be held valid as far as the power of increasing the capital extended and void as to the excess, but are void *in toto*,² the good and bad being indistinguishably blended. So, also, shares issued in pursuance of an unconstitutional statute are void and subject the holder to no liability as shareholder.³ Indeed, even the existence of a general law authorizing an increase of capital will not affect the case where an increase is made by a company incorporated by special act, even though the company might have accepted the general law as an amendment to its charter.⁴

All these cases should be carefully discriminated from cases in which the company has the power to make the increase of capital but in making it omits some of the prescribed formalities.⁵

§ 580. **Liability of Company for Representing overissued Shares to be valid.** — If the holders of overissued shares have been induced to pay for the shares by the company's representations that the shares in question are part of its authorized capital, then the holders may have a right of action against the company for damages, the company being estopped to deny the truth of its representations. As this estoppel usually arises in cases of transfers of shares, where the transferee is ignorant of the facts surrounding the issue of the shares and relies upon the representation contained in the share-certificate that the shares have a real and not a merely fictitious existence, the subject is dealt with in connection with transfers of shares.⁶

§ 581. **Liability on Contract to issue valid Shares.** — Moreover, if the company has contracted with a subscriber to issue to him shares of its capital, the issue of shares in excess of its authorized capital amounts to a breach of contract, for which it would seem that the subscriber might have an action of assumpsit for his damages.⁷ The only ground on which the contrary conclusion could be sustained would be that the contract was *ultra vires* and therefore void.⁸ An answer to this argument

¹ *Laredo Imp. Co. v. Stevenson*, 66 Fed. 633; 13 C. C. A. 661.

² *Kampman v. Tarver*, 87 Tex. 491; 29 S. W. 768.

³ *Marion Trust Co. v. Bennett* (Ind.), 82 N. E. 782.

⁴ *Marion Trust Co. v. Bennett* (Ind.), 82 N. E. 782.

⁵ See *infra*, § 592.

⁶ See *infra*, § 908–§ 923, especially § 909.

⁷ Cf. *supra*, § 230.

⁸ Cf. *Anthony v. Household Sewing Machine Co.*, 16 R. I. 571; 18 Atl. 176; 5 L. R. A. 575.

would be that the company has power to issue shares and that whether or not the legal limit of the capital has been exceeded lies peculiarly within its own knowledge, so that the contract is at worst within the class of contracts which are not apparently *ultra vires* but are objectionable only by reason of some secret fact within the company's own knowledge.¹

§ 582. **Illegal Increase no Effect on old Shareholders — Not Ground for Receiver.** — The illegal issue of new shares should not be allowed to affect the rights of the old shareholders.² Certainly it is no ground for the appointment of a receiver for the corporation.³

§ 583—§ 619. *INCREASE UNDER STATUTORY AUTHORITY.*

§ 583. **What will confer Authority to Increase Capital — Authority to issue Convertible Bonds.** — Statutory authority to effect an increase of capital often exists. A statute which authorizes a corporation to issue bonds convertible at the election of the holders into shares of capital stock impliedly authorizes the company to increase its capital, beyond the amount fixed and limited by the charter, to the amount necessary to effect such conversion,⁴ and that too without complying with formalities prescribed by another statute empowering the company under certain circumstances to increase its capital.⁵ But if the issue of the bonds in such a case be a mere scheme or device to accomplish an increase of capital stock, a court of equity will enjoin the proceeding as a fraud on the law.⁶

§ 584. **Amount and Kind of Increase — Successive Increases — New Shares of different par Value from old.** — Usually, general incorporation laws expressly provide some means by which companies organized under them may increase their capital. Often the amount of the increase is entirely within the discretion of the company; but sometimes statutes limit the amount to which the increase may go. A power of increasing the capital is not ordi-

¹ As to which see *infra*, § 1061. Barb. (N. Y.) 637, 669–675; *Ramsey*

² *Byers v. Rollins*, 13 Colo. 22; *v. Erie Ry. Co.*, 38 How. Pr. (N. Y.) 21 Pac. 894. 193, 216–217.

³ *Virginia-Carolina Chemical Co. v. Provident Sav., etc. Ass. Soc. (Ga.)*, 54 S. E. 929. ⁵ *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637, 669–675.

⁴ *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637, 669–675. ⁶ *Belmont v. Erie Ry. Co.*, 52 Barb. (N. Y.) 637, 669–675.

narily exhausted by one increase, but may be exercised repeatedly by successive increases.¹ Where, however, the statute provides that the increase shall not exceed double the amount of the authorized capital, the meaning is that the company shall not either at one time or by successive increases enlarge its capital beyond twice the amount originally fixed.² A statute authorizing an increase to an amount equal to two thirds of the capital actually paid in refers to the amount paid in at the time the increase is authorized by resolution rather than at the time the new shares are issued.³ It has also been held that such a statute refers to the actual value of the capital paid in and not to the nominal amount credited as paid up on the shares.⁴

Where a statute authorizes a corporation to increase its capital by the issue of additional shares, it is not necessary that the new shares be of the same denomination or par value as the old shares.⁵

§ 585-§ 592. *How Increase may be effected.*

§ 585. **Required Formalities.** — The formalities required by the several incorporation acts of the American states and of Great Britain in order to effect an increase of capital differ so widely among themselves that any attempt to set forth the requisites prescribed by the various laws would be both tedious and unprofitable. If no formalities be prescribed by the enabling act, the increase may be accomplished by mere resolution duly entered on the company's minutes declaring an increase *in presenti*.⁶ But if the increase is to be made by amending the incorporation paper and no method of making the amendment is prescribed, then the amendment must be executed and acknowledged in the same way as the original incorporation paper.⁷

¹ *Massey Mfg. Co.*, 13 Ont. App. 446.

² *Berg v. San Antonio Street Ry. Co.*, 17 Tex. Civ. App. 291; 42 S. W. 647; 43 S. W. 929; *Scovill v. Thayer*, 105 U. S. 143 (headnote inadequate).

³ *Continental Varnish, etc. Co. v. Secretary of State*, 87 N. W. 901; 128 Mich. 621.

⁴ *Person & Riegel Co. v. Lipps*

(Pa.), 67 Atl. 1081 (where the actual value of the capital paid in exceeded the nominal amount paid upon the shares).

⁵ *Sewell's Case*, 3 Ch. 131, 141.

⁶ *Sutherland v. Olcott*, 95 N. Y. 93, 99. Cf. *Payson v. Stoeber*, 2 Dillon 427.

⁷ *Palmer v. Bank of Zumbrota*, 72 Minn. 266, 277; 75 N. W. 380.

Where the power of increasing the capital is conferred upon the corporation as a whole, it can be exercised only by the shareholders and not by the directors;¹ but if the power be conferred on the directors, it may be exercised by them without the consent or authority of the shareholders.²

Where an amendment to the articles of association is a statutory prerequisite to an increase of capital, the issue of the new capital cannot be authorized simultaneously with, or prior to, the consummation of the resolution amending the articles;³ but it is not necessary that the articles should be first amended and that afterwards another meeting of the shareholders should be held to authorize the additional capital, for the issue of the new capital may be authorized at the same meeting that finally adopts the alteration of the articles.⁴

If the filing of a certificate showing the amount of capital paid in be a statutory condition precedent to a lawful increase of capital, a certificate stating that the amount of the company's capital is \$12,000 "and all but . . . paid in," is construed to mean that all has been paid in and therefore complies with law.⁵

Where the certificate of increase is incomplete in that some of the particulars embodied in the resolution of the company authorizing the increase and required by statute to be mentioned in the certificate are omitted, the registrar may be required to file and record an amended certificate supplying these defects;⁶ for the original certificate not being in accordance with the actual facts or in compliance with the law may be disregarded.

§ 586. **Requisites of Meeting at which Increase is voted.** — The meeting, whether of the shareholders or directors, at which the resolution making the increase is passed must be a valid meeting, and the requisites of a valid meeting are determined by principles of law which are elsewhere stated.⁷ If the meeting

¹ *Railway Co. v. Allerton*, 18 Wall. 233; *Eidman v. Bowman*, 58 Ill. 444; 11 Am. Rep. 90; *Humboldt Driving Park Ass'n v. Stevens*, 34 Nebr. 528; 52 N. W. 568; 33 Am. St. Rep. 654.

Cf. *Bailey v. Champlain, etc. Co.*, 77 Wisc. 453; 46 N. W. 539 (where the shareholders had acquiesced in the action of the directors).

See *infra*, § 1438.

² *Sutherland v. Olcott*, 95 N. Y. 93, 99.

³ Cf. *Patent Invert Sugar Co.*, 31 Ch. D. 166.

⁴ *Campbell's Case*, 9 Ch. 1.

⁵ *Moosbrugger v. Walsh*, 89 Hun (N. Y.) 564, 567; 35 N. Y. Supp. 550.

⁶ *State ex rel. Ely, etc. Co. v. Swanger*, 195 Mo. 539; 93 S. W. 932.

⁷ See *infra*, § 1193 et seq., § 1445 et seq.

is required to be convened by notice of any particular form or for any specified length of time, the requirement will be construed in the same way as other requirements as to notice of company meetings. That is to say, the notice will be deemed to have been designed for the benefit of the members, and the lack of it may be waived by those who are not properly notified.¹ Where the statute requires the resolution for an increase of capital to be passed at a meeting called for the purpose, the requirement is not satisfied by a notice stating that the meeting is called to act on a report of the board of directors, although that report recommended the increase and had been generally circulated among the shareholders.² Under a statute which requires a notice stating "what increase is proposed to be made in the capital stock or indebtedness of the corporation," one notice of an intention to increase both the capital stock and the bonded indebtedness is sufficient;³ and, if the statute also provide that the increase may be either equal to or less than that stated in the notice, a notice giving the maximum amount of the proposed increase is good.⁴

§ 587. **Motives actuating Increase, how far material.** — The motive of the increase is no concern of the registrar charged with the duty of recording the certificate of increase. Hence, he may not refuse to record the certificate on the ground that the increase was made immediately after the incorporation of the company for the purpose of avoiding a tax which would have been payable if the enlarged capital had been provided for in the certificate of incorporation.⁵ On the other hand, if the increase is for a fraudulent purpose, the defrauded party may doubtless enjoin its consummation or have it set aside.⁶ So, as will presently

¹ *Nelson v. Hubbard*, 96 Ala. 238; 11 So. 428; 17 L. R. A. 375; *State ex rel. Norvell-Shapleigh Hardware Co. v. Cook*, 178 Mo. 189; 77 S. W. 559 (overruling *State ex rel. Donnell Mfg. Co. v. McGrath*, 86 Mo. 239). See also *infra*, § 1210.

² *Palliser v. Home Telephone Co.* (Ala.), 44 So. 575.

³ *Palliser v. Home Telephone Co.* (Ala.), 44 So. 575, 579 (headnote inadequate).

⁴ *State ex rel. Home Bldg., etc. Ass'n v. Rotwitt*, 17 Mont. 537; 43 Pac. 922 (where it was said that the objection could only be made by the state on *quo warranto*).

⁵ *Donald v. American Smelting, etc. Co.*, 62 N. J. Eq. 729; 48 Atl.

⁶ *Jones v. Concord, etc. R. R. Co.*, 67 N. H. 119, 140 (headnote inadequate); 38 Atl. 120.

Cf. *Jones v. Concord, etc. R. R. Co.*, 67 N. H. 234; 30 Atl. 614; 68 Am. St. Rep. 650; *Finley Shoe & Leather Co. v. Kurtz*, 34 Mich. 89

be shown, any shareholder may enjoin an increase which is proposed to be made without recognizing his prior right to subscribe to his proportion of the new shares.¹

§ 588. **Examination of Proceedings by Public Official — Certificate of Regularity.** — Statutes sometimes provide that the proceedings looking to an increase of capital shall be scrutinized by some public official who before the increase can be made must certify that they comply with law.² Notably, a provision of this sort is found in the National Banking Act. In construing this provision, the federal courts have held that the certificate of the comptroller of the currency, to whom is intrusted the duty of examining the proceedings under which the increase is to be made, conclusively establishes that the proceedings are legal and regular.³ For example, the certificate precludes the objection that the requisite two-thirds vote was not cast for the resolution to increase the capital.⁴ But notwithstanding the comptroller's certificate, directors who falsely represent that profits sufficient for the declaration of a stock dividend have been earned and who by these means induce the comptroller to approve the increase of capital involved in such a dividend, are liable to the company for its damages.⁵ Moreover, notwithstanding the certificate, any person who is alleged to have subscribed for the new shares is free to show that he never became a shareholder.⁶ But a subscriber to the new shares cannot escape liability because the comptroller issued the certificate after the bank was known to be insolvent and for the mere purpose of subjecting to liability as shareholders persons who had subscribed to new shares and had been held out as shareholders for several years, but who had never become actual shareholders

771 (increase for the purpose of issuing the new stock for less than par enjoined).

¹ *Infra*, § 614.

² As to similar provisions applicable to reductions of capital, see *infra*, § 646. Such a certificate of increase of capital by an officer of another state may be received in evidence although not certified in accordance with the Act of Congress: *Person & Riegel Co. v. Lipps* (Pa.), 67 Atl. 1081.

³ *Columbia Nat. Bank v. Mathews*,

85 Fed. 934; 29 C. C. A. 491; *Tillinghast v. Bailey*, 86 Fed. 46; *Latimer v. Bard*, 76 Fed. 536; *Brown v. Tillinghast*, 93 Fed. 326; 35 C. C. A. 323.

Cf. *Scott v. Deweese*, 181 U. S. 202; 21 Sup. Ct. 585.

⁴ *Bailey v. Tillinghast*, 99 Fed. 801; 40 C. C. A. 93.

⁵ *Cockrill v. Abeles*, 86 Fed. 505; 30 C. C. A. 223.

⁶ *Bailey v. Tillinghast*, 99 Fed. 801, 809 (headnote inadequate); 40 C. C. A. 93.

because the certificate necessary to consummate the legal increase of capital had been withheld.¹

§ 589. **Whether full Amount of new Stock must be taken.** — An increase of capital may in ordinary cases be complete before the whole number of the new shares is subscribed for. Moreover, calls may be made upon a subscriber to shares issued by way of increase of capital even though the entire amount of the increase has not been subscribed for.² The reason for holding that a subscriber to shares in the original capital of a corporation is not liable for calls until the entire capital has been subscribed is that the company is not authorized to commence business and therefore can have no need of money before its capital is wholly taken; but this reason has no application to shares which are issued by way of increase of capital, for the company is usually engaged in the lawful prosecution of its business before the increase is projected. Where, however, the increase is made before the company has begun business and when only a very few shares have been issued, the increase being accompanied by a change in the par value of the shares, a person who shortly before the increase subscribes to shares of the new par value cannot be called upon to pay until the entire new capital is subscribed.³

§ 590. **Provision confining Increase to Number of Shares taken.** — Although ordinarily the nominal authorized capital may be increased before all the new shares are taken, yet sometimes sub-

¹ *Bailey v. Tillinghast*, 99 Fed. 595; 10 Sup. Ct. 417; *Scott v. De-weese*, 181 U. S. 202; 21 Sup. Ct. 801; 40 C. C. A. 93.

² *Clarke v. Thomas*, 34 Ohio St. 585. But see *Read v. Memphis Gayoso Gas Co.*, 9 Heisk (Tenn.), 545 (some expressions thrown out by the court *obiter* being difficult to reconcile with the authorities cited by the court); *Winters v. Armstrong*, 37 Fed. 508 (overruled by Supreme Court cases, *supra*). In *Hahn's Appeal*, 7 Atl. Rep. 482 (Pa.) the subscription was subject to an express condition that it should not be binding unless the whole of the proposed increase should be subscribed.

Cf. *Avegno v. Citizens Bank*, 40 La. Ann. 799; 5 So. 537; *Pacific Nat. Bank v. Eaton*, 141 U. S. 227 (headnote inadequate); 11 Sup. Ct. 984; *Thayer v. Butler*, 141 U. S. 234; 11 Sup. Ct. 987; *Butler v. Eaton*, 141 U. S. 240; 11 Sup. Ct. 985; *Aspinwall v. Butler*, 133 U. S. 95 Md. 367; 52 Atl. 975.

scription of the whole number of new shares is expressly made a condition precedent to the accomplishment of any increase; and sometimes it is provided that the increase shall extend only to the number of shares that may be subscribed for within a certain time. For instance, where the company, having power to increase its capital from \$25,000 to \$1,000,000, resolves to open its books for thirty days for subscriptions for \$600,000, the meaning is not that a present increase of capital to the amount of \$600,000 be then and there made but rather that the increase to be made extend to so much only of the \$600,000 as may be subscribed within the thirty days.¹

§ 591. **Whether Subscriber to new Shares becomes a Shareholder before Payment in full.** — The question whether a subscriber to shares which are part of an increase of capital can become an actual shareholder before he has paid for the shares in full has been considered elsewhere.² The National Banking Act provides that "no increase of capital shall be valid until the whole amount of such increase is paid in"; but this provision does not have the effect of invalidating shares of increased capital that have been fully paid for, merely because some of the other shares are not paid for; and therefore the holder of such paid-up shares is subject to the statutory liability of shareholders to creditors.³

§ 592. **Consequences of Failure to comply with Statutory Requirements.** — As to cases where a company, having statutory power to increase its capital, attempts to do so without observing the statutory conditions,⁴ there is both in England and America considerable conflict of authority. There seems to be no doubt that though the statutory conditions are disregarded at the time the increase is made, yet a subsequent compliance with the terms of the law validates the issue.⁵ But even where the statutory requirements or conditions have never been fully complied with, the decided weight of American authority and several important English cases hold that the non-compliance is a

¹ *Read v. Memphis Gayoso Gas Co.*, 9 Heisk. (Tenn.) 545.

² *Supra*, § 174. Compare also *infra*, § 779.

³ *Scott v. Latimer*, 89 Fed. 843; 33 C. C. A. 1.

⁴ Compliance with the statutory

provisions should be presumed. *Man v. Boykin* (S. Car.), 60 S. E. 17.

⁵ *Sewell's Case*, 3 Ch. 131. Cf. *First Nat. Bank v. Wyoming Valley Ice Co.*, 136 Fed. 466; *Pacific Mill Co. v. Inman, Poulsen & Co.* (Oreg.), 90 Pac. 1099.

mere irregularity of which, after a subscriber to the new shares has acted and been treated as shareholder, both he and the company will be estopped to take advantage.¹ On the other hand, authority is not lacking for the view that statutes authorizing corporations to increase their capital confer a special power and

¹ *Miller's Dale Co.*, 31 Ch. D. 211; *Campbell's Case*, 9 Ch. 1; *Richmond's Case*, 4 K. & J. 305; *Payson v. Withers*, 5 Biss. 269; *Barrows v. Natchang Silk Co.*, 72 Conn. 658; 45 Atl. 951 (certificate of increase not filed for record as required); *Bailey v. Champlain, etc. Co.*, 77 Wisc. 453; 46 N. W. 539; *Hoeft v. Kock*, 123 Mich. 171; 81 N. W. 1070; 81 Am. St. Rep. 159 (resolution making increase not recorded as required); *Clarke v. Thomas*, 34 Ohio St. 46; *Scovill v. Thayer*, 105 U. S. 143, 149 (explaining *Upton v. Trebilcock*, 91 U. S. 45; *Chubb v. Upton*, 95 U. S. 665; *Pullman v. Upton*, 96 U. S. 328); *Handley v. Stutz*, 139 U. S. 417, 424-426; 11 Sup. Ct. 530; *Peck v. Elliott*, 79 Fed. 10, 18; 24 C. C. A. 425; 38 L. R. A. 616 (failure to pay a tax on increase as required); *Olson v. State Bank*, 67 Minn. 267; 69 N. W. 904; *Veeder v. Mudgett*, 95 N. Y. 295, 309-311; *Columbia Nat. Bank v. Mathews*, 85 Fed. 934; 29 C. C. A. 491; *Tillinghast v. Bailey*, 86 Fed. 46; *Latimer v. Bard*, 76 Fed. 536; *Scott v. Deweese*, 181 U. S. 202; 21 Sup. Ct. 585; *Manufacturers' Paper Co. v. Allen-Higgins Co.*, 154 Fed. 906 (certificate not recorded as required by statute as condition precedent to validity of new shares); *Thunder Hill Mining Co.*, 4 Brit. Columb. 61 (resolution not duly passed and not recorded but subscribers liable as contributories in winding-up, with which decision compare *Twigg v. Thunder Hill Mining Co.*, 3 Brit. Columb. 101, where a person who had accepted some of the same issue of new shares was relieved of them, while the company remained a going concern, on pro-

ceedings to rectify the register of shareholders); *Pope v. Merchants' Trust Co.* (Tenn.), 103 S. W. 792 (subscriber liable in liquidation although assets sufficient to pay creditors in full); *Man v. Boykin* (S. Car.), 60 S. E. 17.

Cf. *Kansas City Hotel Co. v. Hunt*, 57 Mo. 126 (where recorded certificate of increase did not state all data required by law); *Western Nat. Bank v. Armstrong*, 152 U. S. 346, 354; 14 Sup. Ct. 572; *McFarlin v. First Nat. Bank*, 68 Fed. 868; 16 C. C. A. 46 (where the comptroller of the currency had never certified his approval of the increase as required by law); *Sayles v. Brown*, 40 Fed. 8 (where the company never approved the increase by a valid majority vote); *First Nat. Bank v. Wyoming Valley Ice Co.*, 136 Fed. 466 (as to non-payment of required tax on increase of capital); *Gowdy Gas, etc. Co. v. Pattison*, 64 N. E. 485; 29 Ind. App. 261; *Cunningham v. German Ins. Bank*, 101 Fed. 977; 41 C. C. A. 609 (held, that the amount which the company might borrow should be determined with reference to the capital as irregularly increased, no formal resolution of the shareholders, as required by law having been recorded, but only an amendment to the incorporation paper signed by the president and secretary); *Farmers' L. & T. Co. v. Toledo, etc. Ry. Co.*, 67 Fed. 49, 56-58 (similar point to that of preceding case); *Pool v. West Point Butter, etc. Co.*, 30 Fed. 513 (as to amount of authorized indebtedness determined with reference to the capital).

that unless the terms of the statute (except such as can be deemed directory merely) are strictly pursued, the power fails altogether and the case is to be treated as if no statute were in existence, so that the new shares are wholly void.¹ At any rate, until the statutory conditions have been performed, the inclination of the courts will be to hold that acts looking to an increase of capital were not intended to operate as a present issue of additional shares but merely as steps taken with a view to effecting an increase of capital in the future by first complying with the statutory formalities and then issuing new shares.² Moreover, a mere executory contract of subscription to shares constituting part of an increase of capital will not be specifically enforced in equity unless all the requirements of law as to the manner of issuing the new shares have been complied with;³ and similarly, if the company is suing to enforce a contract one of the conditions of which is that the capital shall have been increased, the company must show that the increase has been duly made.⁴

¹ *Bank of Hindustan, etc. v. Alison*, L. R. 9 C. P. 222 (relating to the same issue held to be valid in *Campbell's Case*, ubi supra); *McCord v. Ohio, etc. R. R. Co.*, 13 Ind. 220; *Lincoln v. New Orleans Express Co.*, 45 La. Ann. 729; 12 So. 937 (where the subscriber recovered back from the company the sums paid on the shares); *Schierenberg v. Stephens*, 32 Mo. App. 314 (where the company being insolvent, the subscriber recovered back from the receiver the amounts paid in on the shares); *Railroad v. Sneed*, 99 Tenn. 1; 41 S. W. 364; 47 S. W. 89 (where the subscriber to the new shares successfully defended an action for calls); *Winters v. Armstrong*, 37 Fed. 508.

Cf. *Spring Co. v. Knowlton*, 103 U. S. 49, 57 (headnote inadequate); *Wood v. Union Gospel Church Bldg. Ass'n*, 63 Wisc. 9; 22 N. W. 756; *Lathrop v. Kneeland*, 46 Barb. (N.

Y.) 432; *American Tube Works v. Boston Machine Co.*, 139 Mass. 5; 29 N. E. 63 (relating to an attempted issue of "special stock" under a Massachusetts statute); *Tschumi v. Hills*, 6 Kan. App. 549; 51 Pac. 619; *Palmer v. Bank of Zumbrota*, 72 Minn. 266; 75 N. W. 380 (where the subscribers to the new shares irregularly issued were allowed to stand as creditors upon their claim to recover back money paid upon the new shares, in competition with prior, but not subsequent creditors of the corporation, to whom indeed the holders of new shares were held subject to a statutory liability).

² See *Spring Co. v. Knowlton*, 103 U. S. 49, 57 (headnote inadequate); *McFarlin v. First Nat. Bank*, 68 Fed. 868; 16 C. C. A. 46.

³ *Smith v. Franklin Park, etc. Co.*, 168 Mass. 345; 47 N. E. 409.

⁴ *Pacific Mill Co. v. Inman, Poulsen & Co.* (Oreg.), 90 Pac. 1099.

§ 593. **Rescission of Increase.** — A resolution increasing the capital, once duly passed in pursuance of a statutory power, cannot subsequently be revoked or rescinded even before the new shares are actually issued, except in the mode, if any, provided for reducing the capital.¹

§ 594. **Contracts to exercise Statutory Power of Increase.** — A contract by a corporation to exercise its statutory power of increasing its capital would seem, at least under some statutes, to be unenforceable and void. For if such a contract could be enforced, the statutory conditions and formalities would be reduced to a mere ceremony which the company could not refuse to perform, and thus indirectly by making the contract the company would bind itself to do that which can be done directly only by observing the statutory requirements.² Perhaps the question depends on the nature of the statutory conditions. For instance, if a vote of two thirds of the shareholders is required by statute as a condition to increasing the capital, obviously a contract to increase the capital authorized by a bare majority of the shareholders could not bind the minority. But on the other hand, where the only requirement is that the resolution making the increase be recorded in a public registry, the argument is very forcible that recording is a mere formality which is required before the increase can be actually made but which is not at all necessary for a mere contract to make the increase. The objection, moreover, goes rather to the remedy of specific performance than to the validity of the contract; for even a corporation which has no power at all to increase its capital may be required to respond in damages to a person to whom it has contracted

¹ *Sutherland v. Olcott*, 95 N. Y. *Machine Co.*, 16 R. I. 571; 18 Atl. 93; *Moses v. Ocoee Bank*, 1 Lea 176; 5 L. R. A. 575. (Tenn.) 398, 408 (semble).

But see *Terry v. Eagle Lock Co.*, 47 Conn. 141. But see *Reid v. Detroit Ideal Paint Co.*, 94 N. W. 3 (headnote inadequate); 132 Mich. 528 (where a

Cf. *Hollingshead v. Woodward*, 35 Hun (N. Y.) 410; *Nettles v. Marco*, 33 S. Car. 47; 11 S. E. 595. subscription to shares to be issued by increase of capital though made before the increase was accomplished was held binding); *Bratten*

² See *Finley Shoe & Leather Co. v. Kurtz*, 34 Mich. 89; *McNulta v. Corn Belt Bank*, 164 Ill. 427; 45 N. E. 954; 56 Am. St. Rep. 203. *v. Catawissa R. R. Co.*, 211 Pa. 21; 60 Atl. 319 (bonds convertible into stock at the option of the holder enforced).

Cf. *Anthony v. Household Sewing*

to issue valid shares¹ or whose right to valid shares it is estopped from denying.²

§ 595. **Contracts to refrain from exercising Statutory Power.** — A contract not to exercise the statutory privilege of increasing the capital stands on a different footing. The true rule is submitted to be that a company cannot contract itself out of its statutory power, but that on the other hand a contract that no exercise of the power shall affect the rights of certain privileged shareholders would be competent.³ At any rate, a provision in the by-laws or internal regulations forbidding an increase of capital although all the statutory conditions are complied with, unless certain other conditions are performed, is quite nugatory.⁴

§ 596—§ 602. *Stock Dividends.*

§ 596. **Legality of Stock Dividends.** — So-called “stock dividends”⁵ constitute a peculiar form of increase of capital that is not infrequently met with in America. A company, having accumulated profits which would be available for distribution among the shareholders in the shape of dividends, determines to retain the profits for the expansion of its business and to distribute new shares, to a par value equal to the amount of the profits, among the old shareholders. Such a scheme is obviously an increase of capital, which the law does not permit without some affirmative statutory provision. To be sure, even without special authority the company might have retained the undrawn profits for use in its business — in other words, might have virtually

¹ Supra, § 581.

² Supra, § 580, and infra, § 909.

³ Cf. infra, § 671, where the similar question as to reductions of capital is discussed.

See also *Martin v. Remington-Martin Co.*, 95 N. Y. App. Div. 18; 88 N. Y. Supp. 573; *Howell v. Chicago, etc. Ry. Co.*, 51 Barb. (N. Y.) 378, 381.

⁴ *Ayre v. Skelsey's Adamant Cement Co.*, 20 Times L. R. 587 (affirmed on another ground in 21 Times L. R. 464). See infra, § 696.

⁵ For a case where a “stock

dividend” was held not to be a dividend within the meaning of a statute requiring the company to pay interest on amounts subscribed by certain municipal corporations until the first dividend, see *Hardin County v. Louisville, etc. R. R. Co.*, 92 Ky. 412; 17 S. W. 860. Cf. *Louisville, etc. R. R. Co. v. Hart County* (Ky.), 75 S. W. 288; 25 Ky. Law Rep. 395.

As to whether stock dividends are taxable as dividends, see *Commonwealth v. Pittsburg, etc. Ry. Co.*, 74 Pa. St. 83.

capitalized the profits;¹ but the objectionable feature is the increase in nominal or share capital — the capital stock, as we say in America. One need not speculate *why* the law should freely permit an increase in the actual capital but should frown upon an increase in the nominal capital. Suffice it to say that the nominal capital is fixed and limited by the incorporation paper in pursuance of statute while no limit is usually put upon the actual capital which the company may accumulate. Perhaps one reason for the apparent anomaly is that by increasing the nominal capital the company could diminish the apparent profitability of its undertaking and thus perhaps by a certain kind of misrepresentation ward off demagogic attacks, in state legislatures and elsewhere, upon the supposedly undue or unconscionable prosperity of the corporation. At all events, if the company's legal capital has been fully issued, a stock dividend is an increase of capital, and as such is permissible only by virtue of affirmative statutory authority.² When a corporation has the power to increase its nominal capital and also has an accumulated surplus, the law does not prohibit the distribution of new shares to the extent of the company's surplus among the old shareholders as a dividend, provided the formalities prescribed for an increase of capital be observed.³

¹ *Barry v. Merchants' Exchange Co.*, 1 Sandf. Ch. (N. Y.) 280. See also *infra*, § 1345.

² Cf. *Bailey v. Railroad Co.*, 22 Wall. 604 (where a company having no power to increase its capital and being restricted by statute to annual dividends of ten per cent, issued to its shareholders, to represent their interest in accumulated earnings, scrip-certificates entitling the holders to share *pro rata* with holders of capital stock in subsequently declared dividends and generally to enjoy substantially all the rights of shareholders except that of voting, and was held subject to a tax on scrip-dividends, the validity of the scrip-dividends being assumed and no point being made, that the issue thereof amounted to an evasion of the law preventing an increase of capital). See also *Brundage v.*

Brundage, 60 N. Y. 544, where the court left open the question as to the legality of the scrip-dividend involved in *Bailey v. Railroad Co.*, *ubi supra*.

As to distributing among the shareholders as a dividend shares which after being issued have been acquired by the company by purchase or otherwise, see *Commonwealth v. Boston & Albany R. R. Co.*, 142 Mass. 146; 7 N. E. 716; *Dock v. Schlichter, etc. Co.*, 167 Pa. St. 370; 31 Atl. 656. See *infra*, § 1385.

As to using money of the corporation to pay for shares to be issued to a third person as trustee for the existing shareholders, see *Jones v. Morrison*, 31 Minn. 140; 16 N. W. 854.

³ *Williams v. Western Union Tel. Co.*, 93 N. Y. 162; *Re Barton's Trust*, 5 Eq. 238, 244 (headnote

§ 597. **Necessity that Profits equivalent to amount of Stock Dividend should be in Hand.** — In order to sustain such a stock dividend, there must be evidence that the company has in hand the requisite amount of surplus profits.¹ Thus, where the state constitution forbids the issue of stock except for money or property, a stock dividend of one hundred per cent on the old shares, where there is no affirmative proof that funds to such an extent in excess of the original capital are actually in hand, will be enjoined.²

§ 598. **Consequences of an Illegal Stock Dividend.** — Even if the company is without power to declare a stock dividend, a shareholder cannot recover the amount of the dividend in money. He must either take the shares as offered to him or do without any dividend at all.³

§ 599. **Necessity for distributing Stock Dividends equally.** — Of course, a stock dividend, like any other dividend, must be distributed among the shareholders *pro rata*.⁴ This rule corresponds with the rule that where new shares are offered for subscription the old shareholders are entitled to a preference over strangers.

§ 600. **Stock Dividend distinguished from Cash Dividend accompanied by Option to subscribe to new Shares.** — A stock dividend differs from a cash dividend accompanied by an offer of the proposed new shares to the old shareholders for subscription, in that in the case of a stock dividend no shareholder has any option to take cash and decline the stock.⁵ To be sure, he may refuse to accept the new shares which the company offers to

inadequate); *Howell v. Chicago, etc. Ry. Co.*, 51 Barb. (N. Y.) 378, 380; *Cunningham v. German Ins. Co.*, 101 Fed. 977, 981 (headnote inadequate).

But see *Hoole v. Great Western Ry. Co.*, 3 Ch. 262, criticised *infra*, § 1356.

¹ *Cockrill v. Abeles*, 86 Fed. 505; 30 C. C. A. 223.

Cf. *Commonwealth v. Boston, etc. R. R. Co.*, 142 Mass. 146; 7 N. E. 716 (where the rule was held to be dispensed with by a statute authorizing the company to dispose of the shares as its absolute property); *Hoole v. Great Western Ry. Co.*, 3 Ch. 262 (where a dividend payable in

shares exceeding in par value the amount declared to be available for dividend was held to be unlawful under a statute forbidding the use of money raised by calls on shares for payment of dividends).

² *Fitzpatrick v. Dispatch Pub. Co.*, 83 Ala. 604; 2 So. 727.

³ *Rand v. Hubbell*, 115 Mass. 461, 478; 15 Am. Rep. 121.

Cf. *Harris v. San Francisco Sugar Ref. Co.*, 41 Cal. 393, 408.

⁴ *Knapp v. Publishers, etc. Co.*, 127 Mo. 53; 29 S. W. 885; *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196.

⁵ *Lyman v. Pratt*, 183 Mass. 58; 66 N. E. 423.

distribute to him; but he cannot obtain cash in lieu of the stock.¹ On the other hand, where a cash dividend is declared, accompanied by an offer of new shares *pro rata* with the amount of the dividend credited as paid thereon, it would seem that any shareholder may elect to take the cash and to refuse the new shares,² although indeed Lord Watson seems to have been of a contrary opinion on this point.³ According to Lord Watson's view a transaction of that sort is in substance identical with a stock dividend.⁴

§ 601. **Rescission of Stock dividend.** — A stock dividend should also be distinguished from a cash dividend in that in the case of cash dividend, the right of the shareholder becomes indefeasible immediately upon the declaration of the dividend, and the company cannot subsequently rescind its action. In the case of a stock dividend, on the other hand, until the formalities required by law as conditions precedent to an increase of capital have been completed, all is *in fieri*, so that until then the company may revoke the dividend.⁵ The reason of this rule applies, however, only where the stock dividend involves an increase of the company's nominal capital, and therefore a dividend payable in shares which had been purchased by the company should be in this respect assimilated to a cash dividend, and is irrevocable.⁶

§ 602. **Sale of new Shares in Market followed by Distribution of Premium among old Shareholders.** — A method of increasing capital, which has been sometimes employed, and which somewhat resembles a "stock dividend," although it certainly cannot properly be called by that name, consists in selling the new shares in the market and distributing the premium obtained from the sale among the old shareholders. Such a distribution is not a dividend within the meaning of a law levying a tax upon "divi-

¹ Cf. *State v. Baltimore, etc. R. R. Co.*, 6 Gill (Md.) 363 (where the dividend was declared payable in bonds).

² *Bouch v. Sproule*, 12 A. C. 385, 398 (per Lord Herschell). Cf. *Malam v. Hitchens* (1894), 3 Ch. 578.

³ *Bouch v. Sproule*, 12 A. C. 385, 404.

⁴ See *infra*, § 1380, § 1386.

⁵ *Terry v. Eagle Lock Co.*, 47 Conn. 141.

⁶ *Dock v. Schlichter Jute Cordage Co.*, 167 Pa. St. 370; 31 Atl. 656.

dends" paid to shareholders.¹ Moreover, money so distributed should, it seems, be regarded as capital rather than income as between a tenant for life and remainderman of the old shares.²

§ 603—§ 619. RIGHT OF OLD SHAREHOLDERS TO PREFERENCE IN ALLOTMENT OF NEW SHARES.

§ 603. **In general.** — Usually, where the capital of a corporation is increased by the issue of additional shares, the old shareholders have a right to subscribe to the new shares in proportion to their holdings in the existing capital, before the new shares can be allotted to outsiders. A right of this sort is often expressly conferred by statute or by the company's incorporation paper or regulations. Where that is the case, the extent of the right will depend of course on the terms of the particular statutes or regulations by which the right is conferred. To give the old shareholders such a preferential right of subscribing to the new shares is generally a wise and just provision; for in that way the several shareholders, provided they possess sufficient pecuniary resources to exercise the right, are enabled to preserve their proportionate interest in the company. The American cases and text-writers generally state that the same absolute right inheres in each of the old shareholders even apart from any express statute or resolution;³ and this doctrine has recently been

¹ *State v. Franklin Bank*, 10 Ohio St. 91 (headnote inadequate). *Co.*, 90 N. W. 1040; 131 Mich. 79; 100 Am. St. Rep. 582; *Electric Co.*

² *Leland v. Hayden*, 102 Mass. 542. See *infra*, § 1334. But see *Wiltbank's Appeal*, 64 Pa. St. 256, 259; 3 Am. Rep. 585. *v. Edison Electric, etc. Co.*, 200 Pa. 516; 50 Atl. 164; *Wall v. Utah Copper Co.* (N. J.), 62 Atl. 533.

³ *Real Estate Trust Co. v. Bird*, 90 Md. 229; 44 Atl. 1048 (semble); *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156; *Jones v. Concord, etc. R. R. Co.*, 67 N. H. 119; 38 Atl. 120; *Eidman v. Bowman*, 58 Ill. 444 (semble); 11 Am. Rep. 90; *Humboldt Driving Park Ass'n v. Stevens*, 34 Nebr. 528; 52 N. W. 568; 33 Am. St. Rep. 654 (semble); *Jones v. Morrison*, 31 Minn. 140, 151-153; 16 N. W. 854; *State ex rel. Page v. Smith*, 48 Vt. 266, 289 (semble); *Hammond v. Edison Illuminating*

But see *contra*: *Ohio Ins. Co. v. Nunemacher*, 15 Ind. 294; *Meredith v. New Jersey Zinc & Iron Co.*, 55 N. J. Eq. 211, 219-220; 37 Atl. 539; affirmed short in 56 N. J. Eq. 454; 41 Atl. 1116 (where the new stock was issued in exchange for property). Cf. *Re Wheeler*, 2 Abb. Pr., n. s. (N. Y.), 361, 363; *Morris v. Stevens*, 178 Pa. St. 563, 578-579; 36 Atl. 151 (where it was said that the shareholders themselves may order that the new shares be offered for public subscription).

affirmed, after full consideration, by the Court of Appeals of New York.¹ If this be so, however, the shareholders cannot claim as of right to subscribe to the new shares at par if they could be sold in the market at a greater price;² but can at most claim the right to subscribe for the new shares at the same price as could be got for them in the market from a stranger. It would seem, however, that where by statute or resolution, the old shareholders are entitled to their proportion of the new shares, their right is *prima facie* a right to subscribe at par.³ Certainly, it is not illegal to permit the old shareholders to subscribe for the new shares *pro rata* at par even though the shares could be sold in the market for a larger sum.⁴ It has been said *obiter* that a majority of the shareholders may "provide for a sale in parcels or bulk at public auction, when every stockholder can bid the same as strangers";⁵ but this dictum, inasmuch as it would enable the wealthy shareholders to "squeeze out" their poorer fellows by offering the new shares in large blocks for which only men of great means could bid, has been forcibly criticised.⁶

§ 604. **Exceptional Cases.**—The issue of bonds convertible into shares at the option of the holder without according any pre-emptive right to the existing shareholders is certainly no less objectionable than the issue of the new shares *in presenti* to strangers instead of to the old shareholders.⁷ If the increase of capital is effected upon an amalgamation with another company to whose shareholders the new shares are issued, it has been

¹ *Stokes v. Continental Trust Co.*, 186 N. Y. 285; 78 N. E. 1090.

² *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 301; 78 N. E. 1090.

Cf. *Ohio Ins. Co. v. Nunemacher*, 10 Ind. 234, 236; 15 Ind. 294; *Milner v. Illinois Central R. R. Co.*, 24 Barb. (N. Y.) 312, 329-330; *Meredith v. New Jersey Zinc & Iron Co.*, 55 N. J. Eq. 211, 219-220; 37 Atl. 539; affirmed short in 56 N. J. Eq. 454; 41 Atl. 1116 (where the new shares were issued in exchange for property).

But see *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156; *Hammond v. Edison Illuminating Co.*, 90 N. W. 1040; 131 Mich. 79; 100 Am. St. Rep. 582.

³ Cf. *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156; *Cunningham's Appeal*, 108 Pa. St. 546; *Attorney-General v. Boston & Maine R. R.*, 109 Mass. 99.

⁴ *Jones v. Concord, etc. R. R. Co.*, 67 N. H. 234, 239; 30 Atl. 614; 68 Am. St. Rep. 650.

Cf. *State v. Bank of Charleston*, Dud. (S. Car.) 187; 39 Am. Dec. 135.

⁵ *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 298; 78 N. E. 1090 (semble).

⁶ See N. Y. Financial Chronicle, Vol. 83 (Dec. 8, 1906), p. 1380, 1381.

⁷ *Wall v. Utah Copper Co.* (N. J.), 62 Atl. 533.

held that the old shareholders of the corporation which absorbs the other company have no right to demand any of the new shares.¹ It has been thought that the common law pre-emptive right of the old shareholders does not exist if the new shares are not to be issued for cash, but are to be paid for in property.²

§ 605-§ 609. *In whom the Right vests.*

§ 605. **In general.** — The right of the old shareholders to a preference in the distribution of the new shares, whether created by statute or by the terms of the resolution authorizing the increase of capital, belongs to those persons who are members of the company when the increase is made. Hence, it may be claimed by the executors of a deceased shareholder although they have never been registered as shareholders in the place of their testator.³ An owner of scrip or bonds convertible at the holder's option into shares has no right to participate in an issue of additional shares made before he exercises his option.⁴ The time of the increase for the purpose of determining who are entitled to subscribe to new shares is taken to be the time when the increase is definitively resolved upon by the corporation and made part of the constitution of the company.⁵

§ 606. **Relative Rights of Transferor and Transferee.** — An assignment of the shares prior to the increase would of course convey this right along with other incidents of ownership to the

¹ *Bonnet v. First Nat. Bank*, 60 S. W. 325; 24 Tex. Civ. App. 613; *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 299; 78 N. E. 1090 (semble).

² *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 298, 299; 78 N. E. 1090 (semble). Cf. *Meredith v. New Jersey Zinc & Iron Co.*, 55 N. J. Eq. 211; 37 Atl. 539; affirmed short in 56 N. J. Eq. 454; 41 Atl. 1116.

³ *James v. Buena Ventura Nitrate Co.* (1896), 1 Ch. 456.

Cf. *Jackson v. Turquand*, L. R. 4 H. L. 305; *Leeds Banking Co.*, 1 Ch. 231; *Bushee v. Freeborn*, 11 R. I. 149 (as to the relative rights of specific and residuary legatees to shares subscribed to by the executor).

⁴ *Miller v. Illinois Central R. R. Co.*, 24 Barb. (N. Y.) 312; *Pratt v. American Bell Tel. Co.*, 141 Mass. 225; 5 N. E. 307; 55 Am. St. Rep. 465.

⁵ *Real Estate Trust Co. v. Bird*, 90 Md. 229, 245 (headnote inadequate); 44 Atl. 1048.

Cf. *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196 (as to stock dividends).

As to whether a holder of redeemable shares is entitled to participate in an allotment of new shares issued for the purpose of obtaining the funds necessary to consummate the redemption, see *Weidenfeld v. Northern Pac. Ry. Co.*, 129 Fed. 305, 309-310; 63 C. C. A. 537.

transferee; but there would seem to be no objection to an express reservation of the right by the assignor, although the reservation would be operative only in equity. Where the increase is made after a contract for the sale of shares has been entered into but before it has been executed, the right of pre-emption as between the vendor and the purchaser vests in the latter.¹ But the vendor is under no obligation to advance his own money in order to procure the new shares for the purchaser, and by failing to do so and thus suffering the pre-emptive right to be lost, he incurs no liability to the purchaser, who if he wished to avail of the option of pre-emption should have provided the vendor, the holder of the legal title to the old shares, with the necessary funds.² It has been said that an assignment of the original shares after the option to subscribe for the rateable portion of the new capital has been exercised but before the new shares have been actually issued will carry as an incident the right of the assignor to the new shares when issued;³ but the questions suggested by this dictum, which are merely questions of the presumed intention of the parties, would seem to depend in large measure on the terms of the statute or by-law by which the pre-emptive right of the old shareholders is conferred or regulated.

§ 607. **Relative Rights of Tenant for Life and Remainderman of old Shares.**—The privilege of subscribing to the new shares is not to be deemed income and therefore does not enure exclusively to the benefit of a tenant for life of the old shares, but the new shares when subscribed to, or the proceeds of sale of the pre-emptive right if it be sold, constitute part of the corpus of the estate.⁴ In those states which adopt the Pennsylvania rule of apportioning extra dividends between life tenant and

¹ *Currie v. White*, 45 N. Y. 822 § 1386); *Atkins v. Albree*, 12 Allen (Mass.) 359; *Leland v. Hayden*, 102

² *Currie v. White*, 45 N. Y. Mass. 542; *Re Kernochan*, 104 N. Y. 618, 630; 11 N. E. 149; *Biddle's Appeal*, 99 Pa. St. 278; *Moss's Appeal*, 83 Pa. St. 264; 24 Am. Rep. 164; *Walker v. Walker*, 68 N. H. 407 (headnote inadequate); 39 Atl. 432;

³ *Baltimore City Pass. Ry. Co. v. Hambleton*, 77 Md. 341, 350-351 (semble — headnote inadequate); 26 Atl. 279.

⁴ *Sanders v. Bromley*, 55 L. T., N. S., 145; *Malam v. Hitchens* (1894), 3 Ch. 578 (stated infra, § 1380); *Davis v. Jackson*, 152 Mass. 58 (headnote misleading); 25 N. E. 21; 23 Am. St. Rep. 801 (stated infra, presumptively capital); 29 Atl. 636;

remainderman according to the time when the profits out of which they are declared are earned,¹ there would seem to be no reason why so much of the value of the pre-emptive right as is due to profits earned during the pendency of the life estate should not be treated as income, as indeed was done in a recent New Hampshire case;² but the cases are, to say the least, rare in which life tenants even in states which adopt the rule of apportioning stock dividends have been awarded any part of the value of the pre-emptive right.³

§ 608. **Relative Rights of Preferred and Common Shareholders.** — The right *inter sese* of holders of preferred shares and of holders of ordinary or common shares to participate in an increase of capital has been considered in connection with the subject of preferred shares.⁴

§ 609. **Rights of Shareholder who has not fully paid for old Shares.** — The fact that a larger proportion has been paid in on some shares than on others is no reason for denying to the holders of the latter the same right of pre-emption as the holders of the former have. So far is this principle carried that even a shareholder who is in default for non-payment of calls has been held to be entitled to participate in an increase of capital *pari passu* with shareholders who are not delinquent.⁵

Hite v. Hite, 93 Ky. 257, 267-268; Supp. 298; *Hyde v. Holmes* (Mass.), 20 S. W. 778; 40 Am. St. Rep. 189; 84 N. E. 318.

19 L. R. A. 173; *Thomson's Estate*, 153 Pa. St. 332; 26 Atl. 652, 653; *Greene v. Smith*, 17 R. I. 28; 19 Atl. 1081 (with which compare *Bushee v. Freeborn*, 11 R. I. 149, where the new shares were issued to the old shareholders on payment of less than the par value); *Brinley v. Grou*, 50 Conn. 66; 47 Am. Rep. 618; *De Koven v. Alsop*, 205 Ill. 309, 319-320; 68 N. E. 930; 63 L. R. A. 587; *Robertson v. De Brulattour*, 80 N. E. 938, 943 (headnote inadequate); 188 N. Y. 301; *Brown v. Brown* (N. J.), 65 Atl. 739; *Curtis v. Osborn* (Conn.), 65 Atl. 968 (holding also that the new shares are held by the trustee subject to the same duties of conversion, etc., as the old); *Love-*

lace v. Anson (1907), 2 Ch. 424; *Richmond v. Richmond*, 108 N. Y. County, 31 Pa. St. 78; 72 Am. Dec. 726. But see *Wiltbank's Appeal*, 64 Pa. St. 256; 3 Am. Rep. 585 (distinguished in Pennsylvania cases cited supra and to be compared with peculiar Pennsylvania rules on a similar subject, *infra*, § 1387-§ 1389). As to the right to subscribe for shares in a subsidiary company organized to lease the property of the principal corporation, see *Wright's Estate*, 24 Pa. Co. Ct. Rep. 376 (where the "adventitious" right was held to be income).

¹ See *infra*, § 1387-§ 1389.

² *Holbrook v. Holbrook* (N. H.), 66 Atl. 124.

³ See Pennsylvania and New Hampshire cases cited *supra*, p. 502, n. 4.

⁴ *Supra*, § 569.

⁵ *Reese v. Bank of Montgomery County*, 31 Pa. St. 78; 72 Am. Dec. 726.

§ 610-§ 611. *Time for Exercise of Right.*

§ 610. **Before Increase of Capital is effected.** — The right cannot well be exercised by anticipation before the increase is determined upon. A shareholder might promise to exercise the right when it accrues, and such a promise if supported by a consideration might operate as a contract which would bind him personally, and perhaps bind any transferee of the shares with notice of the promise.¹

§ 611. **After Expiration of Time limited for Exercise of Right.** — The very nature of the right of the old shareholders to participate *pro rata* in the distribution of new capital before non-members of the company can subscribe thereto presupposes that the right must be exercised in some reasonable time, else it will be lost. Moreover, the company would have the right to name a particular date before which the existing shareholders must subscribe or lose their prior right to do so. The only restriction upon this power of the company is that the date so named must allow the shareholders a fair opportunity to avail themselves of their preference should they be disposed to do so.² When a reasonable date is named at which the shareholders' option of subscribing to the new issue will be terminated, time is of the essence, and no shareholder can subscribe as a matter of right after that date,³ even though his failure to subscribe in time was due to no fault of his. Thus, where the resolution for the issue of new capital was passed on July 25th, and the shareholders were allowed until the 10th of the next month for the exercise of their option, a shareholder who was abroad and who did not learn of the option until August 12th and who thereupon wrote immediately attempting to exercise the option, is too late, and cannot require the company to issue to him his proportion of the new shares.⁴ The only exception to the rule of which the case just stated is an illustration is that if the share-

¹ Cf. *Real Estate Trust Co. v. Bird*, 90 Md. 229, 246; 44 Atl. 1048. held ineffective as to a shareholder who happened to be in Europe).

² *Jones v. Morrison*, 31 Minn. 140, 153; 16 N. W. 854 (where the company's attempt to limit the time within which the old shareholders might subscribe to eleven days was

³ *Hart v. St. Charles Street R. R. Co.*, 30 La. Ann. 758.

⁴ *Pearson v. London & Croydon Ry. Co.*, 14 Sim. 541.

holder's failure to subscribe in due time is due to the company's own fault — for example, if the letter notifying him of his right to subscribe be misdirected — he will be allowed to subscribe within a reasonable time after the expiration of the prescribed period.¹ The company may require a deposit to be paid at the time of subscribing by a shareholder who wishes to exercise his option of subscribing for new shares; and if a shareholder or his assignee fails to make the payment within the stipulated time the right to subscribe is lost.²

§ 612. **Waiver of pre-emptive Right.** — The right of the old shareholders may be waived by them before the expiration of the time for subscribing to the new shares, or, perhaps, even before the increase of capital is made or authorized.³ No such waiver, however, will bind a purchaser of the shares without notice thereof.⁴ The only way in which the company can make such a waiver certainly effective as against a purchaser of the shares is by noting the same on the share-certificate. Inasmuch as the right vests in those persons who are shareholders at the time of the increase, it seems to have been thought that a waiver of the right before that time would not bind a person who, after the waiver but before the increase is resolved upon, acquires shares of the original capital by transfer, even though he have notice of the waiver;⁵ but there would seem to be no reason why an absolute owner of shares should not in equity be allowed to waive the right before it accrues nor why such a waiver should not bind a purchaser with notice, for it must be remembered that the privilege does not come as a mere windfall or gift of Providence to those who are shareholders where the increase is resolved but vests in them in consequence of the rights of ownership which have all along been possessed, potentially at least, by them and their predecessors in title. The fact that a share-

¹ *James v. Buena Ventura Nitrate Syndicate* (1896), 1 Ch. 456.

² *Sewall v. Eastern R. R. Co.*, 9 Cush. (Mass.) 5.

³ Cf. *Hoyt v. Shenango Valley Steel Co.*, 207 Pa. 208; 56 Atl. 422.

⁴ *Real Estate Trust Co. v. Bird*, 90 Md. 229, 246-248; 44 Atl. 1048.

⁵ *Real Estate Trust Co. v. Bird*, 90 Md. 229, 245-246; 44 Atl. 1048.

holder' demands the right to subscribe to the new shares at par, whereas the extent of his legal right is to subscribe at such price as the majority of the shareholders may fix, does not amount to a waiver of his legal right, or justify the company in allotting the new shares to third persons without first offering to the protesting shareholder his proportion of the new shares at the same price as the strangers are willing to pay.¹ Moreover, an acceptance of a part of the new stock to which an old stockholder is entitled does not amount to a waiver of his right to the rest of his quota.²

§ 613. **Assignment of the Right.** — The right may be assigned as well as waived.³ Indeed, such rights are often bought and sold on the stock exchange. As there is no certificate or other tangible evidence of ownership of the right separable from the share-certificate, the purchaser's only security is the promise of the vendor or his broker. When the shareholder has exercised his option of subscribing, he usually receives from the company a scrip-certificate stating that he will be entitled to so many of the new shares when issued; and this certificate may be sold on the stock exchange precisely like a share-certificate.⁴ Such a sale, however, makes the purchaser merely an assignee of a contract and not an actual shareholder. Hence, he cannot compel the company to issue to him a share-certificate for the shares subscribed for by his assignor; and not until the new shares are actually issued does he become a shareholder, entitled to vote and exercise the other rights of a shareholder.⁵ It has been said that an assignment of the original shares after the option to subscribe for a rateable portion of the new capital has been exercised but before the new shares have been actually issued will carry as an incident the right of the assignor to the new shares.⁶

¹ *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 299-301; 78 N. E. 1090.

² *Schmidt v. Pritchard* (Iowa), 112 N. W. 801.

³ *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 297; 78 N. E. 1090, where the court said: "If so situated that he" — i. e., the old shareholder — "could not take it" — i. e.,

the new stock — "himself, he was entitled to sell the right to one who could, as is frequently done."

⁴ As to transfer of the right to the new shares by a sale of the old shares see *supra*, § 606.

⁵ *Baltimore City Passenger Ry. Co. v. Hambleton*, 77 Md. 341; 26 Atl. 279.

⁶ See *supra*, § 606.

§ 614-§ 616. *Remedies against the Company for failing to recognize pre-emptive Right.*

§ 614. **In general.**—If the company disregards or refuses to recognize the rights of an old shareholder to a preference in the allotment of new shares, several remedies are available. He may by bill in equity compel the company to accord him the privilege to which he is entitled, and enjoin it from disregarding his rights.¹ If the company has already issued all the shares to other persons who are entitled to protection as *bona fide* purchasers,² so that specific performance of the duty owed to him by the company is impossible, or if he does not choose to ask for specific performance, he may recover his damages.³ In order to maintain an action for damages, he must first offer and demand to subscribe to the shares to which he is entitled.⁴ The measure of damages in such an action will be the difference between the amount which he would have had to pay to the company for the shares to which he was entitled to subscribe and the value of the shares at the time the company wrongfully refuses

¹ *Dousman v. Wisconsin, etc. Co.*, 21 Atl. 169, 170; *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 40 Wisc. 418; *Cunningham's Appeal*, 108 Pa. St. 546; *Electric Co. v. Edison Electric, etc. Co.*, 200 Pa. 516, 521 (headnote inadequate); 50 Atl. 164; *Schmidt v. Pritchard* (Iowa), 112 N. W. 801.

Cf. *Sewall v. Eastern R. R. Co.*, 9 Cush. 5, 11; *Hammond v. Edison Mfg. Co.*, 90 N. W. 1040; 131 Mich. 79; 100 Am. St. Rep. 582 (mandamus granted against company).

But see *Meredith v. New Jersey Zinc & Iron Co.*, 55 N. J. Eq. 211; 37 Atl. 539, affirmed short in 56 N. J. Eq. 454; 41 Atl. 1116 (where the remedy at law by way of damages was thought adequate).

² Cf. *infra*, § 617.

³ *Real Estate Trust Co. v. Bird*, 90 Md. 229; 44 Atl. 1048; *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156; *Reading Trust Co. v. Reading I. Works*, 137 Pa. St. 282;

21 Atl. 169, 170; *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 301; 78 N. E. 1090.

Cf. *Crosby v. Stratton*, 68 Pac. 130; 17 Colo. 212 (where the injured shareholder sought in vain to recover damages from another shareholder who was alleged to have received more than his just proportion of the new shares).

⁴ *Wilson v. Bank of Montgomery County*, 29 Pa. St. 537; *Reese v. Bank of Montgomery County*, 31 Pa. St. 78; 72 Am. Dec. 726 (where the form of action was assumpsit); *Bonnet v. First Nat. Bank*, 60 S. W. 325; 24 Tex. Civ. App. 613.

Cf. *Hart v. St. Charles Street R. R. Co.*, 30 La. Ann. 758 (where a tender of the amount of the new shares was required by the court).

But see *Stokes v. Continental Trust Co.*, 186 N. Y. 285, 299-301; 78 N. E. 1090.

to issue them to him.¹ The statute of limitations begins to run in favor of the corporation from the time of its refusal to issue to the complainant his proportion of the new shares. If the company exacts the payment of a premium as a condition of allowing a shareholder to subscribe to his proportion of the new shares, it has been held in Pennsylvania that if he pays the premium even under protest, he cannot subsequently recover it back.²

§ 615. **Remedy personal to Shareholder whose Right is denied.** — In order that a shareholder should have a standing in court to complain of the distribution of new or additional shares, he must show some violation of his own personal rights and not merely a violation of the rights of other shareholders. For instance, a common shareholder has no ground of complaint because the preferred shareholders have not been permitted by the company to participate in the allotment of new shares.³

§ 616. **Company not accountable for Premium realized on Quota of Shareholder who has waived or otherwise lost pre-emptive Right.** — A shareholder who waives or omits to exercise his right to subscribe for his proportion of the new shares cannot compel the company to pay him the amount of a premium, or excess over the par value, realized by it on a sale of the shares to which he would have been entitled, unless a statute affirmatively confers such a right.⁴

§ 617. **Rights and Liabilities of Persons to whom new shares are issued in Violation of Pre-emptive Right of old Shareholders.** — If the right of the old shareholders to a preference in the distribution of new shares be disregarded and the new shares be allotted to others, the allotment cannot be cancelled after the shares have come into the hands of *bona fide* holders for value.⁵

¹ *Gray v. Portland Bank*, 3 Mass. 364; 3 Am. Dec. 156.

² *Weidenfeld v. Northern Pac. Ry. Co.*, 129 Fed. 305; 63 C. C. A. 537.

Cf. *Reading Trust Co. v. Reading I. Works*, 137 Pa. St. 282; 21 Atl. 169, 170.

³ *Mason v. Davol Mills*, 132 Mass. 76.

⁴ *De la Cuesta v. Ins. Co.*, 136 Pa. St. 62; 20 Atl. 505; 9 L. R. A. 631.

⁵ *Morris v. Stevens*, 178 Pa. St. 563; 36 Atl. 151.

Cf. *Re Wheeler*, 2 Abb. Pr., n. s. (N. Y.), 361 (where shares issued in

So long as the shares are in the hands of persons who are cognizant of the circumstances under which they were allotted, the issue may be cancelled;¹ and if one of the original allottees has sold some of the new shares to an innocent purchaser, the vendor may be enjoined from voting on or selling a corresponding number of his old shares until the validity of the allotment be finally passed upon.²

§ 618. **Rights of old Shareholders upon Issue of previously unissued Shares of old Capital, surrendered and forfeited Shares.** — Whilst the distinction between an increase of capital and the issue of previously unissued shares of the existing capital or shares which have been surrendered or forfeited must not be overlooked, yet if a corporation has begun business before its capital has been fully subscribed or, as the saying is, with some of its stock remaining in its treasury, it may offer the shares so remaining to the existing shareholders before putting them up for public subscription; and where that is done, the rights of the shareholders are much the same as if the shares so offered had constituted an increase of capital.³ No obligation, however, rests upon the company to offer to its existing shareholders in preference to the public at large any shares of its original authorized capital which it may have in its disposal⁴ — most certainly not where the company is reissuing shares which were surrendered by the original allottees.⁵ But the company has no

disregard of the old shareholders' illustrative of some points in the right of pre-emption were said to be law as to increase of capital. illegal).

¹ Cf. *Schmidt v. Pritchard* (Iowa), 112 N. W. 801 (where the subscribers for the new shares, not being *bona fide* purchasers, were required to recognize the rights of the old shareholders); *Whitaker v. Kilby*, 106 N. Y. Supp. 511 (a similar case).

But see *Shellenberger v. Patterson*, 168 Pa. St. 30; 31 Atl. 943.

² *Morris v. Stevens*, 178 Pa. St. 563, 579-580 (headnote inadequate); 36 Atl. 151.

³ Some cases of this sort, for example, *Jackson v. Turquand*, L. R.

4 H. L. 305, and *Addinell's Case*, 1 Eq. 225, have been cited above as

⁴ *State ex rel. Page v. Smith*, 48 Vt. 266, 289-290; *Hartridge v. Rockwell*, R. M. Charl. (Ga.) 260; *Brown v. Florida Southern Ry. Co.*, 19 Fla. 472; *Curry v. Scott*, 54 Pa. St. 270.

But see *Jones v. Morrison*, 31 Minn. 140, 146 (semble); 16 N. W. 854; *Way v. American Grease Co.*, 47 Atl. Rep. 44, 46; 60 N. J. Eq. 263; *Crosby v. Stratton*, 68 Pac. 130, 132 (semble); 17 Colo. 212.

Cf. *Miller v. Illinois Central R. R. Co.*, 24 Barb. (N. Y.) 312; *Shellenberger v. Patterson*, 168 Pa. St. 30; 31 Atl. 943.

⁵ *Crosby v. Stratton*, 68 Pac. 130; 17 Colo. 212.

right to accord the privilege to some favored shareholders whilst denying it to others.¹ And of course the directors have no right to issue hitherto unissued shares of the original capital to their own friends for the purpose of maintaining themselves in control of the company.² So, where shares have been surrendered to the company as "treasury stock," the directors have no right to sell such shares to a friend for the purpose of maintaining themselves in power, especially where the price to be obtained for them, although under ordinary circumstances a good one, is less than could be realized by taking advantage of the contest for control of the corporation; and if the vendee has notice of the object of the directors, the court will cancel the reissue.³

§ 619. **Distinction between Acceptance of Company's Offer of Quota of new Shares and Application for Shares in Addition to Quota at Suggestion of Company.** — The exercise by shareholders, within the time limited to them, of the right to subscribe for the new shares completes a contract between the company and the shareholder so subscribing.⁴ On the other hand, if the company writes to the various shareholders asking them whether they desire to take any of the new shares over and above their proportion, the company is not making an offer but is merely, as it were, advertising for offers; and therefore a reply by a shareholder signifying his desire to subscribe for a certain number of the new shares in addition to his proper proportion does not complete a contract, but is a mere offer which will not ripen into a contract unless and until it be accepted by the corporation.⁵

¹ *Reese v. Bank of Montgomery County*, 31 Pa. St. 78 (headnote misleading); 72 Am. Dec. 726.

² *Elliott v. Baker* (Mass.), 80 N. E. 450.

³ *Luther v. C. J. Luther Co.* (Wisc.), 94 N. W. 69; 118 Wisc. 112; 99 Am. St. Rep. 977; *Whitaker v. Kilby*, 106 N. Y. Supp. 511 (headnote misleading).

⁴ *Jackson v. Turquand*, L. R. 4

H. L. 305.

⁵ *Addinell's Case*, 1 Eq. 225;

Jackson v. Turquand, L. R. 4 H. L. 305.

§ 620—§ 674. REDUCTION OF CAPITAL.

§ 620—§ 621. *Definition.*

§ 620. **What Reduction of Capital means.** — Reduction or decrease of capital means either a return to shareholders of actual capital once paid in or contributed by them to the common stock,¹ or a release of shareholders from a liability once incurred to make such contribution if and when called upon to do so, or a diminution in the nominal amount of the capital by cancelling some of the shares or by reducing the nominal or par value of some or all of the existing shares.

§ 621. **What it does not mean.** — It is scarcely necessary to say that the mere fact that a corporation is parting with some of its property does not indicate a reduction of capital in the legal sense. Whenever such a surrender of corporate property is reasonably necessary for the attainment of the objects for which the company was formed, it cannot be said to be a reduction of capital, even though no immediate return is secured to the company. Thus, where an investment company holds railway shares, it may, in compliance with a scheme for reorganizing the railroad, surrender some of its holdings with a view to improving the value of the remainder: to regard such a surrender as a reduction of capital would be an entire misconception.² Even where losses are sustained in the prosecution of the business so that the company's actual capital is impaired, there is nevertheless no return of actual capital to the shareholders and no diminution in the nominal capital; and consequently there is no reduction of capital in the legal sense.³ Of course, a sale of part of the company's capital to one of the shareholders at a fair price is not forbidden as a reduction or return of capital.⁴

¹ Cf. *Audenried v. East Coast Milling Co.*, 59 Atl. (N. J.) 577, 585 (where it was said that a return of capital once paid in was a withdrawal of "capital stock" within the meaning of a statute); *Whitwham v. Piercy* (1907), 1 Ch. 289 (holding that payment of money to shareholders to go in reduction of paid-up capital and to be subject to be called up again by company is reduction of capital requiring legislative sanction). See also § 497.

² *Thompson v. Trustees, etc. Corporation* (1895), 2 Ch. 454. Cf. *Beardslee v. Shickler* (Pa.), 68 Atl. 44.

³ *Cunningham v. German Ins. Bank*, 101 Fed. 977; 41 C. C. A. 609.

⁴ *Robinson v. Muir* (Cal.), 90

Moreover, a distribution of new shares among the existing shareholders as a stock dividend is not a payment or return of capital stock to the stockholders: it is an increase rather than a reduction of the capital stock.¹

§ 622-§ 624. *Why Reduction of Capital without affirmative Legislative Sanction is forbidden.*

§ 622. **Reduction of Actual Capital.** — As heretofore stated, a reduction of capital affects the rights of shareholders and especially creditors more seriously than an increase. The capital of a corporation or limited company is the fund provided by law for the carrying on of its business and the payment of its debts; and any attempt, without special legislative authority to diminish the same is both *ultra vires* and illegal,² and should be ruthlessly stricken down by the courts. This rule is founded in the policy of the law, and cannot be evaded by any artifice. A decrease of capital, so far as creditors are concerned, is most serious when it takes the form of a return to shareholders of capital once paid in³ or of a release from liability for uncalled capital.

§ 623. **Reduction of Nominal Capital.** — But a reduction in the nominal amount of capital may also be very objectionable, and unless clearly authorized by statute should be held to be illegal even though it may be designed merely to make the nominal capital correspond with the actual capital as diminished by losses.⁴ For instance, if a corporation could reduce its nominal capital, it could subsequently treat any excess in the value of

Pac. 521; *Chase v. Mich. Tel. Co.*, 121 Mich. 631; 80 N. W. 717 (sale of company's entire property and business to a corporation which is owner of all except eight of the shares).

¹ *Williams v. Western Union Tel. Co.*, 93 N. Y. 162.

² *Haas Co.*, 131 Fed. 232.

Cf. *Droitwich Patent Salt Co. v. Curzon*, L. R. 3 Ex. 35 (holding that an unlimited company, or partnership, which under its deed of settlement possessed the power to reduce

its capital, loses that power upon becoming incorporated with limited liability under the Companies Acts, although the statute provided that existing companies when incorporated under the act should retain the powers conferred by their deeds of settlement).

³ Cf. *Holmes v. Newcastle-upon-Tyne Abattoir Co.*, 45 L. J. Ch., N. S., 383.

⁴ *Dane v. Young*, 61 Me. 160, 169-170 (headnote inadequate).

its assets over the capital as so reduced as representing surplus or profits available for distribution among the shareholders as dividends.¹ So, too, the effect of a reduction of the nominal capital, if valid, would be to diminish *pro tanto* any statutory liability of shareholders to creditors which may be measured by the nominal or par value of the shares.²

§ 624. **General Principle.**—At all events, the true view would seem to be that the capital having been fixed by the memorandum of association or incorporation paper is by statute made irreducible except in the mode, if any, expressly provided by law, and that whether in any particular case a reduction of capital in a certain way would be hurtful either to creditors or shareholders is a question with which the courts need not concern themselves.³ Whether a particular decrease of capital be good or bad policy for the corporation, be injurious or beneficial to the shareholders, be fraught with danger to creditors or in no way jeopardizing their interests, — these are not questions for the courts; for every decrease of capital is forbidden by the legislature by the very scheme of incorporation, unless some clear statutory sanction can be found.

In a recent California case, a corporation was formed, under a statute authorizing incorporation for any lawful objects, for the purpose of developing and selling a tract of land, which was accepted in payment for shares of the capital stock, in parcels or building lots. The incorporation paper provided that as portions of the tract should be sold, the proceeds of sale should be divided among the shareholders. Undoubtedly, this provision attempted to authorize a reduction of the actual capital. Nevertheless, the court held that the provision was valid, and that any shareholder might compel a distribution of the proceeds of sales, even against the opposition of other shareholders.⁴ The court emphasized the fact that the rights of creditors were not involved in the proceeding. Nevertheless, it is submitted that a contrary decision would have been more consistent with the legal theory of the nature of a corporation,⁵ and that the proper course to

¹ See *infra*, § 1314.

⁴ *Baldwin v. Miller & Lux* (Cal.),

² See *Dane v. Young*, 61 Me. 160, 92 Pac. 1030.
169–170 (headnote inadequate).

⁵ See *supra*, § 53 and § 122.

³ *Holmes v. Newcastle-upon-Tyne Abattoir Co.*, 45 L. J. Ch., N. S., 383.

pursue in any such case would be to exercise the statutory power, if any such be conferred upon the company, of reducing the capital.

§ 625-§ 642. *REDUCTION WITHOUT STATUTORY AUTHORITY — EVASION OF PROHIBITION OF REDUCTION.*

§ 625. **Payment of Dividends out of Capital.** — A not uncommon and exceedingly pernicious method of violating the rule against reducing or returning capital is by paying so-called dividends out of the company's capital, when no profits properly available for dividends have been earned. This practice amounts to a thinly disguised return of capital to the shareholders,¹ and is carried out by false balance sheets and other fraudulent devices. The rules for determining whether or not moneys available for dividends are in the company's hands are treated in connection with the subject of dividends in general.² So, too, the liability of directors who declare and pay a dividend out of the company's capital will be stated below.³

§ 626-§ 633. *PURCHASE BY COMPANY OF ITS OWN SHARES.*

§ 626-§ 630. *Whether Purchase is lawful.*

§ 626. **On Principle.** — A more subtle method of evading the rule against unauthorized reductions of capital lies in the purchase by a corporation of some of its own shares. Most unquestionably, any such purchase reduces by the amount of the purchase price the fund available for the payment of the company's debts. As such, it brings about a diminution of the company's actual or working capital. It also reduces the nominal capital outstanding. While the purchased shares may doubtless be reissued if the purchase is valid, nevertheless such reissue may never be feasible; for the company may never be able to find a subscriber for the shares. Hence, the purchase by a corporation of its own shares amounts to a reduction of both the

¹ *American Steel, etc. Co. v. Eddy*, holders responsible for the claims of 89 N. W. 952; 130 Mich. 266 (where creditors injured by a withdrawal of capital).

dividends were held liable to creditors under a statute making share-

² *Infra*, § 1313-§ 1344.

³ *Infra*, § 1362.

actual and the nominal capital of the company, and as such it should be held both *ultra vires* and illegal unless clearly sanctioned by statute. It is no answer to say that if the company is thoroughly solvent, so that its assets after the purchase are still amply sufficient for payment of all claims against it, the creditors are not prejudiced. For, while the assets may still remain sufficient, yet they are, after the consummation of the purchase, undeniably less by the amount of the purchase money than they were before; and hence the fund which the creditors had an absolute right to have preserved intact for the payment of their claims has been diminished without their consent. This is obviously true where the shares are purchased with capital moneys of the company; and the real fact is but thinly disguised where they are bought with accumulated profits. For the company after buying the shares might treat them as extinguished and distribute any excess of its assets over its outstanding nominal capital among its shareholders in the shape of dividends.

Moreover, even if it were conceded that under some circumstances the purchase might not injure creditors, yet it most seriously disturbs the rights of shareholders. To enable the corporation to purchase, hold, and vote its own shares would so obviously enable the majority to strengthen their grip upon the company with money belonging in part to the minority, that no one would contend that the corporation should have the right to vote in respect of the purchased shares.¹ Even if the purchased shares be treated as extinguished, the change in the relative position of the majority and minority shareholders, although less in degree, is the same in kind. For example, suppose, as may well be the case, the directors of a corporation own between them forty-nine per cent of the company's capital — say, forty-nine out of a total one hundred shares. If, now, they can with the company's money purchase for the corporation three more shares, their forty-nine shares, formerly a minority of the total capital, are converted into a majority. Prior to the purchase, the directors might have been ousted from control of the company by a combination of all the other shareholders; after the purchase, any such combination would be futile. Can it be that those in control of a corporation can be allowed thus to intrench them-

¹ See *infra*, § 1233.

statute expressly forbade the company to "divide, withdraw, or in any way pay to the stockholders or any of them any part of the capital . . . or reduce its capital stock except as authorized by law," with a proviso allowing the company to accept its own shares in settlement of a bad or doubtful debt, a federal judge held that the company, if at the time not insolvent, might with the assent of all its shareholders purchase a majority of its own shares.¹ In some states, notably in New Jersey, the statutes expressly authorize corporations to purchase shares of their own capital stock;² but even these statutes apply only where the purchase is for a "legitimate corporate purpose" and do not justify the surrender of stock to the company as "treasury stock" in pursuance of an illegal scheme for the issue of shares in exchange for property of less value than the nominal value of the shares.³ If the purchase is directly injurious to the company's creditors, — for example, if the company is insolvent, — all the courts agree that it may be set aside,⁴ even though the shareholder made the contract of sale in good faith without knowledge of the facts concerning the company's financial condition which rendered the sale prejudicial to creditors of the company.⁵ Some

¹ *Castle Braid Co.*, 145 Fed. 224. *Hall v. Henderson*, 126 Ala. 449; 28

² *Chapman v. Iron Clad Rheostat Co.*, 62 N. J. Law 497; 41 Atl. 690.

Cf. *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392, 399 (where the court distinguished between a purchase with money representing capital and a purchase with accumulated profits).

³ *Knickerbocker Importation Co. v. State Board of Assessors* (N. J.), 65 Atl. 913.

⁴ *Clapp v. Peterson*, 104 Ill. 26; *Heggie v. People's Bldg. & Loan Ass'n*, 107 N. Car. 581, 595-596; 12 S. E. 275; *Adams, etc. Co. v. Deyette*, 5 S. Dak. 418, 424-426; 59 N. W. 214; 49 Am. St. Rep. 887; *Columbian Bank's Estate*, 147 Pa. St. 422; 23 Atl. 625, 626, 628; *Carter v. Union Printing Co.*, 54 Ark. 576 (headnote misleading); 16 S. W. 579; *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392; *Currier v. Lebanon Slate Co.*, 56 N. H. 262;

So. 531; 85 Am. St. Rep. 53; 61 L. R. A. 621; *Farnesworth v. Robbins*, 36 Minn. 369; 31 N. W. 349; *S. P. Smith Lumber Co.*, 132 Fed. 618 (proof on note given in payment for stock disallowed in bankruptcy); *State v. Bank of Ogoalla*, 65 Nebr. 20; 90 N. W. 961; 91 N. W. 497; *Olmstead v. Vance, etc. Co.*, 196 Ill. 236; 63 N. E. 634; *Hall v. Alabama, etc. Imp. Co.*, 39 So. 285; 143 Ala. 464; *Alabama, etc. Imp. Co. v. Hall* (Ala.), 44 So. 592 (holding the transaction bad as against subsequent creditors without notice).

Cf. *Payne v. Bullard*, 23 Miss. 88; 55 Am. Dec. 74; *United Society v. Eagle Bank*, 7 Conn. 456; *Tait v. Pigott*, 32 Wash. 344; 73 Pac. 364; *Van Brocklin v. Queen City Printing Co.*, 53 Pac. 822; 19 Wash. 552 (where claim of vendor for purchase money was postponed to claims of other creditors of the company).

⁵ *Commercial Nat. Bank v. Burch*,

authorities, while conceding that the purchase is not *ultra vires*, maintain that any shareholder may object and enjoin the purchase.¹

§ 629. **Purchase on Credit or with Borrowed Money — Issue of Bonds in Exchange.** — Where a corporation has power to purchase its own shares, it may buy them on credit² or may borrow money on mortgage or otherwise — for example, may issue mortgage bonds — to pay for them.³ An issue of bonds in exchange for shares is in effect a purchase of shares with borrowed money, and by parity of reasoning must be sustained.⁴

§ 630. **Purchase by Person Secretly Acting as Agent for Company.** — Even where a purchase of shares by or on behalf of the corporation is forbidden by law, a transfer of shares cannot be annulled because, unknown to the transferor at the time of the contract of sale, the transferee was acting as trustee for the company.⁵

§ 631—§ 632. *Effect of Purchase where a Purchase is deemed Illegal.*

§ 631. **In general.** — Where it is held illegal for a corporation to purchase its own shares, such a purchase even if fully consummated by transfer of the shares and payment of the purchase price may be repudiated and treated as void.⁶ Hence, the purchase money or consideration may be recovered back by the company or its receiver.⁷ If the purchase money was paid

141 Ill. 519; 31 N. E. 420; 33 Am. St. Rep. 331.

¹ *Lowe v. Pioneer Threshing Co.*, 70 Fed. 646.

² *Blalock v. Kernsville Mfg. Co.*, 110 N. Car. 99; 14 S. E. 501. Cf. *Castle Braid Co.*, 145 Fed. 224 (where the vendor was allowed to prove against the company's estate in bankruptcy for the amount of the purchase price).

³ *Berger v. U. S. Steel Corp.*, 63 N. J. Eq. 809; 53 Atl. 68; *First Nat. Bank v. Salem Capital, etc. Co.*, 39 Fed. 89; *Hoskins v. Seaside Ice, etc. Co.* (N. J.), 59 Atl. 645.

But cf. *Coquard v. St. Louis Cotton, etc. Co.*, 7 S. W. Rep. 176 (Mo.).

⁴ See cases cited *supra*, n. 3.

⁵ *Johnston v. Laflin*, 103 U. S. 800; *Crandall v. Lincoln*, 52 Conn. 73, 104–105 (but cf. pp. 103–104, the case of *Eldridge*), 105–108 (the case of *Keigwin & Reynolds*); 52 Am. Rep. 560; *Corn v. Skillern* (Ark.), 87 S. W. 142.

⁶ But see *Joseph v. Raff*, 82 N. Y. App. Div. 47; 81 N. Y. Supp. 546, affirmed short, 176 N. Y. 611; 68 N. E. 1118 (where the company was said to be estopped from questioning the transaction, because the *status in quo* could not be restored).

⁷ *Crandall v. Lincoln*, 52 Conn. 73; 52 Am. Rep. 560; *Percy v. Milton*, 3 La. 568, 580–589 (headnote

to an executor, it may be recovered back from the administrator *de bonis non*.¹ The fact that the vendor did not know who the purchaser was in no respect affects his liability to return the purchase money.² If, however, a shareholder sells to another individual who unknown to him is acting as agent or trustee for the company, the agent or trustee is liable to refund the amount of the purchase money to the corporation, but the innocent vendor is not.³ In all these cases, where a recovery of the purchase money is sought, the remedy is, at least according to a Connecticut decision, in equity as well as at law.⁴ *A fortiori*, if the consideration remains unpaid, it cannot be recovered from the company.⁵ If the shares sold to the company were not fully paid, the vendor remains liable upon them as if no sale had been made,⁶ and moreover will be subject to any statutory liability in

inadequate); *St. Louis Mfg. Co. v. Hilbert*, 24 Mo. App. 338; *Burrows v. Niblack*, 84 Fed. 111; 28 C. C. A. 130 (holding that the action may be maintained without tendering back the stock).

Cf. *Bank of San Luis Obispo v. Wickersham*, 99 Cal. 655; 34 Pac. 444; *Sanderson v. Aetna Iron, etc. Co.*, 34 Oh. St. 442; *Hall v. Henderson*, 126 Ala. 449; 28 So. 531; 85 Am. St. Rep. 53; 61 L. R. A. 621; *Tait v. Pigott*, 32 Wash. 344; *State v. Bank of Ogolalla*, 65 Nebr. 20; 90 N. W. 961; 91 N. W. 497.

¹ *Crandall v. Lincoln*, 52 Conn. 73, 102-103; 52 Am. Rep. 560 (the case of Tracy's Estate).

Cf. *Tait v. Pigott*, 38 Wash. 59; 80 Pac. 172.

² *Crandall v. Lincoln*, 52 Conn. 73, 103-104; 52 Am. Rep. 560. Cf. *Tait v. Pigott*, 38 Wash. 59; 80 Pac. 172.

³ *Crandall v. Lincoln*, 52 Conn. 73, 104-105 (but cf. pp. 103-104, the case of Eldridge), 105-108 (the case of Keigwin & Reynolds); 52 Am. Rep. 560.

See also *supra*, § 630.

Cf. *Hall v. Henderson*, 126 Ala. 449; 28 So. 531; 85 Am. St. Rep. 53; 61 L. R. A. 621; *Falls City Tinware Co.'s Trustee v. Levine* (Ky.), 104 S. W. 716.

⁴ *Crandall v. Lincoln*, 52 Conn. 73, 108-110; 52 Am. Rep. 560.

⁵ *Hamor v. Taylor-Rice Engineering Co.*, 84 Fed. 392; *State v. Bank of Ogolalla*, 65 Nebr. 20; 90 N. W. 961; 91 N. W. 497.

But see *Chapman v. Iron Clad Rheostat Co.*, 62 N. J. Law 497, 499; 41 Atl. 690 (where the court, after deciding that the purchase was authorized by statute, declared that if it had not been authorized, the shareholder having fully performed on his part would have been entitled to enforce the *ultra vires* contract against the company).

⁶ *Carter v. Union Printing Co.*, 54 Ark. 576 (headnote misleading); 16 S. W. 579; *Mann v. Pentz*, 2 Sandf. Ch. (N. Y.) 257; *Vale of Neath & South Wales Brewery Co.*, 3 De G. & Sm. 96 (where the purchase was made by an agent known to be acting on the company's behalf and where the transfer remained unquestioned for years).

Cf. *Colonial Investment & Agency Co.*, 19 Vict. L. R. 381 (where the argument was advanced in vain that the company itself had paid the amount due on the shares so that they should be deemed fully paid).

favor of creditors — even subsequent creditors.¹ If the vendor, being ignorant that the company is the real purchaser, execute a transfer in blank, and if the transfer is not registered, he remains liable as shareholder.² The transferor, even after the lapse of years, may compel the company to recognize him as shareholder and restore his name to the register in respect of the surrendered shares.³ A shareholder who made no objection to the purchase of shares by the company and who afterwards sells some of his shares to a third person cannot be heard to allege that the purchase by the company was *ultra vires* and that therefore the shares purchased enured to the benefit of the then shareholders in proportion to their holdings, instead of becoming corporate property distributable as dividends among those who are shareholders when the dividend is declared; for if the purchase was void the title never passed from the company's vendor and the complaining shareholder is out of court.⁴

§ 632. **Purchase by Company followed by Reissue to another Person.** — If shares are purchased by the corporation and subsequently reissued to another person, the two transactions when consummated may sometimes be deemed equivalent to a transfer from the vendor to the second allottee and therefore effective; and this is true even though the purchase by the company was illegal.⁵ So, where a corporation in defiance of law lends money on the security of shares in its own capital and upon default in payment of the debt sells the shares, the pledgor

¹ *Chrisman-Sawyer Banking Co. v. Independence Wool Mfg. Co.*, 68 S. W. 1026; 168 Mo. 634; *Walters v. Porter* (Ga.), 59 S. E. 452.

² *Weedon's Case*, 22 Vict. L. R. 235 (distinguishing *Nicol's Case*, 3 De G. & J. 387, where the transfer was nominally to a definite person and not in blank).

³ *Bellerby v. Rowland, etc. S. S. Co.* (1902), 2 Ch. 14.

⁴ *Coleman v. Columbia Oil Co.*, 51 Pa. St. 74.

⁵ See *supra*, § 868.

Cf. *Joseph v. Raff*, 82 N. Y. App. Div. 47; 81 N. Y. Supp. 546, affirmed short in 176 N. Y. 611; 68 N. E. 1118 (where the purchase was made with the intent of immediately re-

issuing but that intention was not carried out); *Weidenfeld v. Northern Pac. Ry. Co.*, 129 Fed. 305; 63 C. C. A. 537; *Lantry v. Wallace*, 182 U. S. 536, 551-556; 21 Sup. Ct. 878; *First Nat. Bank v. Peoria Watch Co.*, 191 Ill. 128; 60 N. E. 859 (where the purchase by the company was held legal).

As to whether the shares in the hands of the second allottee shall be deemed fully paid or not, see *Belknap v. Adams*, 49 La. Ann. 1350; 22 So. 382; *Wallace v. Hood*, 89 Fed. 11. Cf. *Alling v. Wenzel*, 133 Ill. 264, 275-276; 24 N. E. 551; *First Nat. Bank v. Peoria Watch Co.*, 191 Ill. 128; 60 N. E. 859.

cannot recover the purchase money from the company.¹ The illegal character of a company's purchase of its own shares does not make the purchased shares public property or justify any officer of the corporation in appropriating them to his own use.² Thus, where shares are purchased with funds of the company itself, a director without authority from the corporation has no right to issue them to himself; and if he do so, the company may enjoin him from transferring or voting in respect of them.³

§ 633. **Effect of Purchase where a Purchase is deemed lawful.**—The effect of a lawful purchase or other acquisition by a corporation of its own shares is that the shares so purchased or acquired are suspended or temporarily merged or extinguished.⁴ Certainly, the other shareholders do not become individually liable *pro rata* for the amount, if any, remaining unpaid upon the purchased shares.⁵ The purchased shares may, however, be reissued in the same manner as shares of the originally authorized capital which have never been subscribed for or issued.⁶ The terms of the contract of reissue may be such that

¹ *National Bank of Xenia v. Stewart*, 107 U. S. 676; 2 Sup. Ct. 778.

² Cf. *Walden Nat. Bank v. Birch*, 14 L. R. A. 211; 130 N. Y. 221; 29 N. E. 127 (holding that sureties of national bank cashier in whose name shares of the bank's stock are registered as security for a loan made by the bank to the real owner, notwithstanding the Act of Congress which prohibits national banks from lending money on the security of their own stock, are liable for the conversion of the stock to his own use by the cashier).

³ *Dacovich v. Canizas* (Ala.), 44 So. 473.

⁴ *Williams v. Savage Mfg. Co.*, 3 Md. Ch. 418, 451-453 (semble).

Cf. *Western Imp. Co. v. Des Moines Nat. Bank*, 103 Iowa 455, 462-463; 72 N. W. 657; *Knickerbocker Importation Co. v. State Board of Assessors* (N. J.), 65 Atl. 913 (hold-

ing that shares surrendered to or purchased by the corporation are to be treated as outstanding for the purpose of ascertaining the amount of the capital by which the company's franchise tax is gauged, until retired and cancelled under formal proceedings for the reduction of capital); *Pabst v. Goodrich* (Wisc.), 113 N. W. 398 (holding that for the purpose of calculating the number of shares necessary to satisfy a bequest of such number of shares as represent a book value of \$1,000,000, shares which have been lawfully purchased by the company should be treated as still outstanding).

As to voting rights of such shares see *infra*, § 1233.

⁵ *Crawford v. Roney* (Ga.), 55 S. E. 499.

⁶ *Williams v. Savage Mfg. Co.*, 3 Md. Ch. 418, 451-453; *State Bank of Ohio v. Fox*, 3 Blatchf. 431; *Hart-ridge v. Rockwell*, R. M. Charlt. (Ga.)

the purchasers will be entitled to dividends on the shares in question even before the reissue is fully consummated.¹ Nevertheless, the purchased shares are not deemed property of the corporation, and hence do not pass by a sale of all its property, rights, and franchises except the franchise to be a corporation and to carry on business.²

§ 634—§ 641. ACQUISITION BY COMPANY OF ITS OWN SHARES
OTHERWISE THAN BY PURCHASE.

§ 634. **Whether Permissible — In general.** — While, according to what has been submitted to be the better view, a corporation has no implied power to purchase its own shares, yet not every acquisition by a corporation of shares in its own capital is obnoxious to the same objection. For instance, forfeiture of shares for non-payment of calls or other breaches of duty on the part of the holders is permissible.³ Moreover, in certain cases a corporation may accept a surrender of shares. In what cases this may be done consistently with sound principle shall be our next inquiry.

§ 635—§ 637. *Surrender of Shares.*

§ 635. **In general.** — A “surrender” of shares founded upon any valuable consideration moving from the company to the surrenderer is really a purchase, and is liable to the same objections as a purchase for a money consideration.⁴ Consequently, a so-called gratuitous surrender of shares which are not fully paid up is really a surrender in consideration of a release from the liability attaching to the shares, and therefore likewise

260; *Commonwealth v. Boston & Albany R. R. Co.*, 142 Mass. 146; 7 N. E. 716; *Bank of San Luis Obispo v. Wickersham*, 99 Cal. 655; 34 Pac. 444 (where the purchase of the shares was *ultra vires*); *State ex rel. Page v. Smith*, 48 Vt. 266; *City Bank v. Bruce*, 17 N. Y. 507; *Hartley v. Pioneer Iron Works*, 181 N. Y. 73; 73 N. E. 576; *Draper v. Blackwell*, 35 So. 110; 138 Ala. 182.

¹ *Hartley v. Pioneer Iron Works*, 181 N. Y. 73; 73 N. E. 576.

² *Tulare Irrigation Dist. v. Kaweah Canal, etc. Co.*, 44 Pac. Rep. 662 (Cal.).

³ See *infra*, § 808.

⁴ *Trevor v. Whitworth*, 12 A. C. 409, 418, 438 (semble).

Cf. *Colville's Case*, 48 L. J. Ch. 633; *Wallscourt's Case*, 7 Manson 235; *Addison's Case*, 5 Ch. 294.

falls within the ban of the law.¹ A gratuitous surrender of paid-up shares is certainly less objectionable, and might be held legitimate.² So, a bequest to a corporation of its own stock has been held valid.³ It has been held that a surrender of paid-up ordinary shares in exchange for an equivalent amount of preferred shares is valid;⁴ but this decision has been disapproved, perhaps on insufficient grounds, by the very judge by whom it was rendered.⁵ A surrender of shares, whether paid up or not, coupled with a reissue of the same to other persons may be supported as equivalent to a transfer from the surrenderer to the person to whom they are reissued.⁶

§ 636. **Surrender of Shares which are liable to Forfeiture.** — There is no legal obstacle to the acceptance of a surrender of shares which are liable to forfeiture for non-payment of calls,⁷ provided the arrangement is not a mere device to enable the shareholders to retire:⁸ if *bona fide*, it merely relieves the company from going through the formalities attendant upon a forfeiture of shares *in invitum*.⁹

§ 637. **Surrender of Shares in Compromise of Controversy as to Validity of their Issue.** — A corporation may accept a surrender of certain shares, or release part of a subscription, in

¹ *Bellerby v. Rowland, etc. S. S. Co.* (1902), 2 Ch. 14.

Cf. *Walker v. Hacking*, 57 L. T. 763; *Ex parte Jones*, 27 L. J. Ch. 666; *Cooper v. Frederick*, 9 Ala. 738 (where the transaction was held valid); *Bedford R. R. Co. v. Bowser*, 48 Pa. St. 29; *Glenn v. Hatchett*, 91 Ala. 316; 8 So. 656; *Alling v. Wenzel*, 133 Ill. 264; 24 N. E. 551; *Pacific Fruit Co. v. Coon*, 107 Cal. 447; 40 Pac. 542; *Payne v. Bullard*, 23 Miss. 88; 55 Am. Dec. 74; *Farnsworth v. Robbins*, 36 Minn. 369; 31 N. W. 349; *Chrisman-Sawyer Banking Co. v. Independence Wool Mfg. Co.*, 68 S. W. 1026; 168 Mo. 634 (as to "treasury stock"); *Beaconsfield Heights Estate Co.*, 22 Vict. L. R. 97.

² Cf. *Wheeler v. Mineral Farm, etc. Co.*, 31 Colo. 110; 71 Pac. 1101; *Krisch v. Interstate Fisheries Co.*, 81 Pac. 855 (headnote inadequate); 39

Wash. 381; *Bellerby v. Rowland, etc. S. S. Co.* (1902), 2 Ch. 14 (where Cozens-Hardy, L. J., expressed the opinion, *obiter*, that a gratuitous surrender of fully paid shares would be *ultra vires*).

³ *Rivanna Nav. Co. v. Duncans*, 3 Gratt. (Va.) 19.

⁴ *Eichbaum v. City of Chicago Grain Elevators* (1891), 3 Ch. 459.

⁵ *Bellerby v. Rowland, etc. S. S. Co.* (1902), 2 Ch. 14, 29.

⁶ See *supra*, § 632 and *infra*, § 868.

⁷ *Trevor v. Whitworth*, 12 A. C. 409, 438 (semble).

Cf. *Hall's Case*, 5 Ch. 707.

⁸ *Beaconsfield Heights Estate Co.*, 22 Vict. L. R. 97 (which seems to overrule silently an earlier case in the same state, *Melbourne Locomotive & Engineering Works*, 21 Vict. L. R. 442).

⁹ *Infra*, § 826.

compromise or settlement of a *bona fide* dispute whether the shares were validly issued so as to bind the subscriber; and that too even though in point of fact the issue was legal and regular.¹ *A fortiori*, the surrender is good where the issue was capable, legally, of being upset² but where the surrenderer claimed to be relieved upon some ground other than that which would have entitled him to repudiate the shares.³ If the issue was in law valid, such a surrender while effective for the future does not relate back so as to cancel the shares *ab initio*; and hence the compromise or settlement of a *bona fide* dispute whether the surrenderer remains subject to any liabilities attaching to past members of the company.⁴ The surrender is effective although the ground on which the surrenderer repudiated the shares was that his subscription had been induced by fraud or misrepresentation and although the surrender is not accompanied or followed by the removal of his name from the register of members.⁵ In order that a surrender by way of compromise may be valid, there must be a real, *bona fide* dispute as to whether the shares were properly issued.⁶ Moreover, the surrender must be actually intended as a compromise.⁷

§ 638. **Acceptance of Shares in Satisfaction of, or as Security for, a Debt due the Company.** — It has been frequently declared that a corporation may accept from one of its shareholders a surrender of his shares in satisfaction of a debt that could be collected in no other way.⁸ Indeed, there seems to be no reported case

¹ *Bath's Case*, 8 Ch. D. 334; *New Albany v. Burke*, 11 Wall. 96.

Cf. *Morgan v. Lewis*, 46 Oh. St. 1 (headnote inadequate); 17 N. E. 558; *Gelpcke v. Blake*, 19 Iowa 263, 267-269; *Northrop v. Bushnell*, 38 Conn. 498, 511-512; *Whitaker v. Grummond*, 68 Mich. 249; 36 N. W. 62; *Berks & Dauphin Turnpike Road v. Myers*, 6 Serg. & R. (Pa.) 12; 9 Am. Dec. 402; *State v. Oberlin Bldg., etc. Ass'n*, 35 Oh. St. 258; *Philadelphia, etc. R. R. Co. v. Hickman*, 28 Pa. St. 318, 328.

² *Finance & Issue v. Canadian Produce Corp.* (1905), 1 Ch. 37, 45

(subscription to shares induced by innocent misrepresentation).

³ *Wright's Case*, 7 Ch. 55.

⁴ *Bath's Case*, 8 Ch. D. 334.

⁵ *Fox's Case*, 5 Eq. 118.

⁶ *Esparto Trading Co.*, 12 Ch. D. 191. Cf. *Ex parte Jones*, 27 L. J. Ch. 666; *Gill v. Balis*, 72 Mo. 424.

⁷ *Adam's Case*, 13 Eq. 474 (*Quære*: in this case might not an opposite conclusion well have been reached?).

⁸ *Crandall v. Lincoln*, 52 Conn. 73, 100; 52 Am. Rep. 560 (semble); *State v. Franklin Bank*, 10 Oh. St. 91, 97 (semble); *Morgan v. Lewis*, 46 Oh. St. 1, 6 (headnote inade-

which directly supports the contrary of this proposition. Moreover, a corporation may generally accept its own shares as collateral security for an advance to a shareholder.¹

§ 639. **Acquisition of Shares by satisfying Judgment for Converting them.** — A judgment in trover against the corporation for a conversion of any of its shares, at any rate if followed by satisfaction, has the effect of vesting the title to the converted shares in the company; but that circumstance does not justify the courts in refusing justice to the owner of the converted shares.² A compulsory purchase is effected. If, however, the owner of the converted shares instead of instituting promptly an action for the conversion lies by until the company has become insolvent, he will not be permitted to escape liability as a shareholder on the ground that his ownership had ceased in consequence of the conversion.³

§ 640. **Acquisition of Shares in Pursuance of Terms of Original Issue — Redeemable and Convertible Shares.** — The acquisition of shares by a corporation in pursuance of terms of their original issue would certainly seem to be no less objectionable than if the shares had been originally issued absolutely.⁴ Indeed, such acquisition would be in effect the performance of a condition subsequent attached to a subscription to shares — a subject which is elsewhere considered.⁵ Nevertheless, some courts have held

quate); 17 N. E. 558; *German Savings Bank v. Wulfekuhler*, 19 Kan. 60; *Barto v. Nix*, 15 Wash. 563, 568–569; 46 Pac. 1033; *St. Louis Rawhide Co. v. Hill*, 72 Mo. App. 142.

Cf. *Sheffield Nickel Co. v. Unwin*, 2 Q. B. D. 214; *Phosphate of Lime Co. v. Green*, L. R. 7 C. P. 43; *Williams v. Savage Mfg. Co.*, 3 Md. Ch. 418, 451–452; *City Bank v. Bruce*, 17 N. Y. 507; *State Bank of Ohio v. Fox*, 3 Blatchf. 431; *Ex parte Holmes*, 5 Cow. (N. Y.) 426; *Taylor v. Miami Exporting Co.*, 6 Ohio 176; *Draper v. Blackwell*, 35 So. 110; 138 Ala. 182.

¹ Cf. *Williams v. Savage Mfg. Co.*, 3 Md. Ch. 418, 451–452; *Ex parte Holmes*, 5 Cow. (N. Y.) 426. Such transactions are expressly prohibited by the National Banking Act and

some other incorporation laws. See *Bank v. Lanier*, 11 Wall. 369, and *infra*, § 706 n.

² *Ralston v. Bank of California*, 112 Cal. 208; 44 Pac. 476.

³ *Potts v. Wallace*, 146 U. S. 689; 13 Sup. Ct. 196.

⁴ *Olmstead v. Vance, etc. Co.*, 196 Ill. 236; 63 N. E. 634.

Cf. *Davis v. Proprietors of Meeting-House*, 8 Metc. (Mass.) 321 (arising in a state where a corporation is allowed to purchase its own shares).

But see *contra*: *Ophir Consol. Mines Co. v. Brynteson*, 143 Fed. 829; 74 C. C. A. 625 (where the company was expressly prohibited by statute from purchasing its own stock).

⁵ *Supra*, § 224–§ 226.

that even where the corporation is expressly prohibited by statute from purchasing its own shares, a provision for redemption of the shares embodied in the terms of the original issue is valid and enforceable.¹ Indeed, the consensus of American authority seems to be that unless the provision for redemption is kept secret shares may be issued subject to a stipulation that they may be bought back at the option of the holder² or of the corporation.³ In one aspect, a stipulation for redemption at the option of the shareholder when contained in a contract of subscription to shares is more objectionable than a contract by a corporation to purchase shares which have been already issued; for the provision for redemption may, if valid, be enforced against the company even after the company has become insolvent and to the prejudice of its creditors, whereas a contract of purchase of shares is valid only if the company is solvent at the time of the purchase. This consideration has led the Supreme Court of Michigan to hold that the provision for redemption cannot be availed of after the corporation has become insolvent.⁴ But it would seem that this view is hardly logical, and that a better view is that the stipulation is wholly void. Shares convertible into bonds are an example of shares issued upon a condition subsequent or coupled with an agreement on the part of the company to buy them back under certain contingencies. It would seem clear on principle that such convertible shares cannot be issued without affirmative statutory authority.

§ 641. **Acquisition by Company as Trustee for Third Person.** — Whether a corporation formed for the purpose of acting as trustee may acquire and hold shares in itself as trustee for third persons is a rather peculiar question. That it may do so has been held in Iowa,⁵ but as the courts of that state uphold the power of a corporation to purchase its own shares, this case cannot be deemed very persuasive authority in jurisdictions

¹ See *supra*, p. 526, n. 4.

² *Browne v. St. Paul Plow Works*, 62 Minn. 90; 64 N. W. 66; *Vent v. Duluth Coffee, etc. Co.*, 64 Minn. 307; 67 N. W. 70; *Wisconsin Lumber Co. v. Greene*, 127 Iowa 350; 101 N. W. 742; 109 Am. St. Rep. 387; 69 L. R. A. 968; *Fremont Carriage Co. v. Thomsen* (Nebr.), 91 N. W. 376;

65 Nebr. 370; *United States Mineral Co. v. Camden* (Va.), 56 S. E. 561.

³ *Hackett v. Northern Pac. Ry. Co.*, 36 N. Y. Misc. 583; 73 N. Y. Supp. 1087.

⁴ *McIntyre v. E. Bement's Sons* (Mich.), 109 N. W. 45.

⁵ *State ex rel. Higby v. Higby Co.* (Iowa), 106 N. W. 382.

where that power is denied. Nevertheless it should be observed that the acquisition of shares as a mere trustee is free from many if not all of the objections urged above to the power of a corporation to use its funds in purchasing its own shares.

§ 642. **Release of Shareholder from Liability for unpaid Subscriptions to Capital.** — A release of a shareholder from liability differs from a surrender of the shares in that the shares still remain outstanding so that the holder continues to be entitled to all the rights of a shareholder, and so that the nominal capital is not affected.¹ If the release is made upon a valuable consideration moving from the shareholder to the company, and if the consideration is honestly deemed by the corporation equivalent in value to a discharge of the shareholder's liability by payment, the transaction operates in law as an effective discharge of the liability, unless some statute requires payment in cash. If, however, the release is without sufficient consideration² or is a mere device to relieve the shareholder from his legal burdens, the transaction substantially amounts to an issue of the shares at a discount, and is open to the same legal objections, the nature and effect of which will be considered in another place,³ and indeed, is in some respects even more objectionable, since it may operate as a voluntary release or conveyance of a valuable asset and hence may be fraudulent as against creditors under the statute 13 Elizabeth.⁴ If a *bona fide* dispute exists as to whether a person is liable as shareholder, a compromise whereby the shareholder pays a part of what is legally due and is released from liability for the balance is effective.⁵

¹ A surrender of partly paid acknowledged to be due is on as- shares followed by a reissue of cepted principles of law no legal con- paid-up shares to a nominal amount sideration. *World's Fair Excursion Co. v. Gasch*, 162 Ill. 402; 44 N. E. 724; *Northrop v. Bushnell*, 38 Conn. 498.

Vansant Lumber Co. (Pa.), 64 Atl. 394; 215 Pa. St. 75 (where the transaction was upheld).

² *Sawyer v. Hoag*, 17 Wall. 610, 620 (semble).

Cf. *Rider v. Morrison*, 54 Md. 429.

Payment of a less sum than is

³ *Infra*, § 776 et seq.

Cf. *Osgood v. King*, 42 Iowa 478.

⁴ Cf. *Bouton v. Dement*, 123 Ill. 142; 14 N. E. 62.

⁵ *New Haven Trust Co. v. Nelson*, 73 Conn. 477; 47 Atl. 753; *Whitaker*

§ 643-§ 674. REDUCTION UNDER STATUTORY
AUTHORITY.

§ 643. In general — Authority not readily implied. — By statute in England and very generally in the United States, the reduction of capital is, in some cases and under more or less stringent safeguards,¹ expressly authorized. No such power, however, will be ordinarily implied. For instance, the power cannot be implied from an express power to increase the capital *ad libitum*,² nor is it conferred by a general power to make changes in the incorporation paper.³ Where a company which is incorporated by special act has a certain authorized capital, a subsequent amendatory act reducing the amount has been construed as an enabling act merely, so as not to put a legal impediment in the way of issuing the full amount of capital previously authorized.⁴

§ 644. English and American Statutes compared. — The Companies Act of 1862, although it authorized increase of capital made no provision for reduction of capital. This omission was supplied by the Companies Act of 1867, which provided that any company limited by shares might if authorized so to do by its regulations as originally framed or as altered by special resolu-

v. *Grummond*, 68 Mich. 249; 36 N. W. 62.

See also *supra*, § 637, and particularly cases cited, p. 525, n. 1. Cf. *Fuches v. Hamilton, etc. Pub. Co.*, 10 Ont. 497 (where a so-called compromise was held to be beyond the powers of the directors).

¹ Cf. *American Steel, etc. Co. v. Eddy*, 89 N. W. 952; 130 Mich. 266 (where the statute made the shareholders liable to creditors who might be injured by the reduction of capital, to the extent of the sums refunded to them respectively).

As to cases where creditors are prejudiced by a reduction under the forms of law, see *State v. Bank of Ogalalla*, 65 Nebr. 20; 90 N. W. 961; 91 N. W. 497; *Alexander v. Relfe*, 74 Mo. 495 (where shareholders participating in the reduc-

tion were held liable to make good amount abstracted from the company's assets).

A shareholder may enjoin a reduction of capital which is made for an illegal purpose even though all the forms of law be complied with. *Theis v. Durr*, 125 Wisc. 651; 104 N. W. 985; 110 Am. St. Rep. 880; 1 L. R. A., n. s., 571.

² *Sutherland v. Olcott*, 95 N. Y. 93; *Peck v. Elliott*, 79 Fed. 10, 15-16 (headnote inadequate); 24 C. C. A. 425; 38 L. R. A. 616; *Seignouret v. Home Ins. Co.*, 24 Fed. 332.

³ *Seignouret v. Home Ins. Co.*, 24 Fed. 332 (headnote inadequate).

Cf. *Smith v. Goldworthy*, 4 Q. B. 430, 465-466.

⁴ *Agricultural Branch R. R. Co. v. Winchester*, 13 Allen (Mass.) 29.

tion so far alter its memorandum of association "as to reduce its capital."¹ This general power having been limited by a narrow judicial construction,² the Companies Act of 1877 was promptly passed, providing that the general power conferred by the Act of 1867 should "include a power to cancel any lost capital, or any capital unrepresented by available assets, or to pay off any capital which may be in excess of the wants of the company." This act is not to be construed as limiting the general power conferred by the act of 1867 to these enumerated cases.³ Under these statutes, where the proposed reduction involves a return of paid-up capital, or a release from liability to calls, the creditors must be paid or secured, or must assent; and in all cases the reduction must be confirmed by order of court. The court, however, will not refuse its approval to a scheme of reduction which is neither unjust nor oppressive,⁴ so that the English cases are applicable as authorities even in states where no such judicial sanction is required.

The American statutes differ widely among themselves, and from the British law. The general purposes, however, are everywhere the same; namely, to enable a company whose actual capital is greater than its needs to distribute the surplus among its members, and to enable a concern whose nominal capital for any reason is not represented by available assets to write off the excess of its nominal over its actual capital, precautions more or less adequate always being prescribed to secure the rights of creditors. The conceivable means by which these results may be attained are various. For instance, paid-up capital may be distributed *pro rata* among the shareholders and the nominal value of their shares correspondingly reduced; or if the capital has not been wholly paid in, the members may be released from liability for uncalled capital. Or, again, the par value of the shares may be reduced commensurately with a loss of capital sustained by the corporation; or some shares may be cancelled.

§ 645. **Effect of Failure to comply with statutory Conditions.** — The statutory requirements in respect to a reduction of capital should be strictly pursued, as any irregularity or failure to com-

¹ Companies Act, 1867, § 9.

(1895), 1 Ch. 691, 698; *Hyderabad Co.*, 75 L. T. 23 (semble).

² See *infra*, § 647.

³ *Poole v. National Bank of China* (1907), A. C. 229.

Cf. *Poole v. National Bank of China* (1907), A. C. 229.

⁴ *In re Floating Dock, etc. Co.*

ply with the statutory formalities may render the reduction void.¹ Without doubt, where a company has power to reduce its capital by resolution recorded in the same manner as the original incorporation paper, the act of a bookkeeper in undertaking to write off a loss of capital, not sanctioned by any resolution of the shareholders or directors still less by any recorded resolution, does not in law effect any reduction of capital.² A mere irregularity will not *ipso facto* annul the company's corporate existence³ although it might perhaps furnish a ground for *quo warranto* proceedings against the corporation.⁴

§ 646. **Statutes making Certificate of Public Official conclusive Evidence of Regularity.** — Statutes are sometimes encountered which provide that some public official shall scrutinize any proceedings for the reduction of capital and that his determination in favor of their regularity shall be final.⁵ In construing a provision of this sort contained in the Companies Act of 1867, the English Court of Appeal held that the officer's certificate of approval of the reduction precluded an attack upon the validity of the reduction proceedings based upon the fact that an interval of fourteen days as required by law had not elapsed between the meetings at which the resolution making the reduction was passed and the meeting at which it was confirmed, or upon the fact that the "special resolution" amending the articles so as to authorize the reduction — a necessary preliminary under the British statute to a reduction of capital — was invalid for a similar reason;⁶ and a very recent case goes even further and holds that the registrar's certificate was conclusive although no resolution of any kind amending the articles had been passed.⁷

§ 647. **Whether statutory Power extends to all Kinds of Reduction — i. e., Cancellation of Liability, Return of paid-up Capital, and Reduction of Nominal Capital.** — On principle, it would seem

¹ But see *Shoemaker v. Washburn Lumber Co.*, 97 Wisc. 585, 594; 73 N. W. 333.

² *Brown v. Wyandotte, etc. Ry. Co.*, 68 Ark. 134; 56 S. W. 862.

³ See *supra*, § 157.

⁴ *Cunningham v. German Ins. Bank*, 101 Fed. 977, 981; 41 C. C. A. 609 (holding that the amount which the company is authorized to borrow must be determined without reference to the writing off of the lost capital).

⁵ As to similar provisions respecting an increase of capital, see *supra*, § 588.

⁶ *Ladies' Dress Ass'n v. Pulbrook* (1900), 2 Q. B. 377.

⁷ *Re Walker & Smith*, 88 L. T. 792.

clear that a power to reduce capital conferred in general terms by a statute authorizes any form of reduction of capital — that is, either a cancellation or diminution of liability for unpaid capital or a return of paid-up capital or a reduction of nominal capital. That is to say, the statutory power extends to all three of these forms of reduction, although in some cases as will be explained in detail below ¹ a reduction of nominal capital cannot be accomplished without an accompanying reduction of actual capital either by cancellation of liability or by return of paid-up capital, and *vice versa*. To be sure, under the British Companies Act of 1867, it was reluctantly held by Sir George Jessel that the power to reduce capital, although conferred in general terms, did not extend to a reduction of nominal capital unaccompanied by a cancellation of liability for unpaid capital or to any reduction of paid-up capital, and hence that the statute did not authorize a company whose capital had been impaired by losses to reduce the nominal value of paid-up shares; ² but the law as thus announced was speedily altered by Parliament, ³ and the soundness of the decision which occasioned the passage of the act of the legislature has been so often questioned by English judges ⁴ and text-writers ⁵ that the authority of the case is, to say the least, seriously impaired. It is submitted that unless the wording of a statute authorizing a reduction of capital clearly demands so restricted a construction as that of Sir George Jessel, the more liberal rule now expressly enacted into law in Great Britain should be adopted. Indeed, a New York statute authorizing reduction of capital has been thought to apply *only* in cases where a reduction of the nominal, so as to correspond with the actual, capital is sought, so that a return of paid-up capital would not be permissible. ⁶

§ 648. *Return of Actual Capital on Footing that it may be called up again.* — It has been held in England that the statutory power of reduction of capital permits actual capital to be returned

¹ *Infra*, § 660–§ 668.

² *Ebbw Vale Steel, etc. Co.*, 4 Ch. D. 827; *Kirkstall Brewery Co.*, 5 Ch. D. 535.

³ Companies Act, 1877, 40 & 41 Vict., c. 26.

⁴ *Bannatyne v. Direct Spanish Telegraph Co.*, 34 Ch. D. 287, 302;

British & American, etc. Corp. v. Couper (1894), A. C. 399, 412.

Cf. *Poole v. National Bank of China* (1907), A. C. 229.

⁵ 1 *Palmer's Company Precedents*, 9th ed., 1095–1096.

⁶ *Strong v. Brooklyn Cross-Town R. R. Co.*, 93 N. Y. 426.

to the shareholders upon the footing that it may be called up again by the company at pleasure.¹ This is rather a peculiar method of reduction, but no reason is perceived why, if the question should ever arise in America, the same conclusion should not be reached.

§ 649. **Whether Scheme must contemplate Permanent Reduction.** — In order to fall within a statutory power of reduction of capital, a proposed scheme must contemplate, as an English judge has held, a genuine reduction. Hence the judge refused to confirm a scheme whereby certain shares in the nature of founder's shares were to be cancelled and ordinary shares to a much greater nominal amount were to be issued in exchange. The judge concluded that the scheme contemplated no real reduction but rather an increase of capital, and that too without the payment of its par value; and therefore he refused his sanction to the scheme;² but on the other hand upon very similar facts, except that the ordinary shares to be issued in exchange were to be paid for in full in cash, another English judge in a later case sanctioned the scheme.³ This decision seems less technical and therefore preferable.⁴

§ 650. **Whether statutory Reduction may retroactively ratify illegal Reduction.** — It seems that the statutory reduction proceedings cannot be used to ratify a previous illegal return of capital. For example, where a corporation paid profits, which were in hand available for dividends, to the several shareholders with the understanding that the amount so paid should be taken in reduction of the paid-up capital and should be liable to be called up again at the pleasure of the company, an English court held that the transaction could not be validated by a retroactive resolution for reduction of capital subsequently passed under the Companies Act of 1880, but that the amounts so paid to the several shareholders must be treated as ordinary dividends and therefore must go to a tenant for life as income.⁵

§ 651. **Reduction need not affect all Shares equally.** — While no scheme of reduction that by reason of inequality is unjust or

¹ *Fore-Street Warehouse Co.*, 59 L. T., N. S., 214.

Cf. *Whitwham v. Piercy* (1907), 1 Ch. 289.

² *Development Co. of Central and West Africa* (1902), 1 Ch. 547.

³ *Anglo-French Exploration Co.* (1902), 2 Ch. 845.

⁴ Cf. *Poole v. National Bank of China* (1907), A. C. 229.

⁵ *Whitwham v. Piercy* (1907), 1 Ch. 289.

oppressive will be sanctioned by the courts,¹ yet no rule of law requires that all the shares, or even all the shares of the same class, shall be rateably reduced.² Hence, a corporation may reduce its capital, the statutory formalities being followed, by purchasing the shares of certain of its members;³ but, in construing a New Jersey statute, it was thought that the offer of purchase must be extended to every shareholder of the same class.⁴ Similarly, shares which have been surrendered to the company voluntarily⁵ or in compromise of a controversy as to the validity of their allotment⁶ may be written off and cancelled by pursuing the statutory mode for reducing capital.

§ 652. **Assent of Creditors as statutory Condition to Reduction.** — Where the assent of creditors is a condition precedent to the reduction, there must be an affirmative assent; the mere failure to appear and object after due notice is not enough.⁷ Although a lessor's inchoate right against a company for subsequently accruing rent is not a present claim, yet where the confirmation of the reduction by the court is requisite, the judicial sanction will be refused unless a sufficient sum is impounded to meet the claim of a non-assenting lessor for future rent.⁸

¹ Per Lord Herschell in *British & Am. Trustee, etc. Corp. v. Couper* (1894), A. C. 399, 406; *Theis v. Durr*, 125 Wisc. 651; 104 N. W. 985; 110 Am. St. Rep. 880; 1 L. R. A., n. s., 571.

² *Re Gatling Gun Co.*, 43 Ch. D. 628 (overruling *Re Union Plate Glass Co.*, 42 Ch. D. 513); *British & Am. Trustee, etc. Corp. v. Couper* (1894), A. C. 399.

Contra: *Currier v. Lebanon Slate Co.*, 56 N. H. 262; *Niagara Shoe Co. v. Tobey*, 71 Ill. App. 250.

Cf. *Gade v. Forest Glen Brick Co.*, 165 Ill. 367; 46 N. E. 286 (holding that the objection can be made, if at all, only by a shareholder and not by a creditor); *Theis v. Durr*, 125 Wisc. 651, 658; 104 N. W. 985; 110 Am. St. Rep. 880; 1 L. R. A., n. s., 571.

³ *British & Am. Trustee, etc. Corp. v. Couper* (1894), A. C. 399 (overruling dicta in *Re Denver Hotel Co.* (1893), 1 Ch. 495); *Re York Glass Co.*, 60 L. T. 744; *Berger v.*

U. S. Steel Corp., 63 N. J. Eq. 809; 53 Atl. 68; *Donaldson, Coburn & Knox*, 5 N. So. Wales State Rep. 725.

Cf. *Shoemaker v. Washburn Lumber Co.*, 97 Wisc. 585; 73 N. W. 333; *Alexander v. Relfe*, 74 Mo. 495.

Contra: *Currier v. Lebanon Slate Co.*, 56 N. H. 262.

⁴ *Berger v. U. S. Steel Corp.*, 63 N. J. Eq. 809; 53 Atl. 68.

Cf. *Theis v. Durr*, 125 Wisc. 651; 104 N. W. 985; 110 Am. St. Rep. 880; 1 L. R. A., n. s., 571.

⁵ *Re Denver Hotel Co.* (1893), 1 Ch. 495.

⁶ *Re Gatling Gun Co.*, 43 Ch. D. 628.

⁷ *Re Patent Ventilating Co.*, 12 Ch. D. 254, disregarding *Re Credit Foncier of England*, L. R. 11 Eq. 356. The latter case also bears upon the case where under such circumstances some of the creditors are unknown, for example, holders of bonds or debentures payable to bearer.

⁸ *Re Telegraph Construction Co.*, L. R. 10 Eq. 384.

§ 653-§ 657. REDUCTION OF NOMINAL CAPITAL SO AS TO
CORRESPOND WITH THE ACTUAL CAPITAL.

§ 653-§ 656. *Writing off lost Capital.*

§ 653. **Whether authorized by general Power of Reduction.** — We have seen above that according to the weight of authority, a general power to reduce capital may be exercised by reducing the nominal capital in order to make it correspond with the actual capital as diminished by losses; and a number of points in connection with such a reduction of capital have come before the courts for decision.¹

§ 654. **Importance of determining whether a Loss of Actual Capital has occurred.** — The English Companies Act of 1877 expressly authorizes a company under certain conditions "to cancel any lost capital or any capital unrepresented by available assets"; and the English courts have been not infrequently concerned with the question whether a loss of capital within the meaning of this statute has been proved. A very recent case in the House of Lords goes far towards establishing that under the British statutes it is not necessary to prove that the capital proposed to be cancelled is lost or not represented by available assets.² Notwithstanding this case, the earlier English decisions upon the question whether a loss of capital sufficient to justify a reduction of capital are still important in the United States not merely as bearing on questions arising under any American statutes which may confine the right of reduction to cases where capital has been lost, but also on the question, which is everywhere material, whether a reduction of nominal capital must be accompanied or followed by a distribution of assets representing the reduced capital among the shareholders; for as will presently be shown, if the reduction is merely for the purpose of wiping out a loss of capital, no such distribution is necessary or proper.

¹ In addition to the cases cited below, § 654-§ 656, see *infra*, § 662. decision and was laid down by only one of the lords, Lord Macnaghten.

² *Poole v. National Bank of China* (1907), A. C. 229. Note that notwithstanding the headnote in the Law Reports, the proposition that a loss of capital was not essential to be proved was not necessary to the Lord Loreburn, the Lord Chancellor, made a short speech which did not advert to this proposition, and the other two lords who sat in the case contented themselves with concurring in the result.

§ 655. **Rules for determining whether a Loss of Actual Capital has occurred.** — The expenditure of money by the company for any of its legitimate purposes, for example, for preliminary expenses such as the establishment of agencies, was held not to be such a loss of capital as under the British statute would authorize a reduction of the nominal capital.¹ Moreover, it has been held that in ascertaining the assets of the company for the purpose of determining whether a loss of capital has occurred sufficient to justify a reduction, the amount of a fund collected from reserve profits and of the value of goodwill must be taken into account.² But on the other hand, where profits are accumulated as a reserve fund by a trading company and used in its business without distinction from its capital moneys, the company upon subsequently sustaining losses in the business is not bound to charge the whole of such losses against the reserve fund but may treat a fair proportion of the losses as losses of capital justifying a reduction of the nominal capital.³

§ 656. **Whether the Loss should fall on Preferred or Common Shareholders.** — Where a reduction of the corporation's nominal capital is for the purpose of writing off a loss of actual capital sustained by the company the reduction should be thrown upon that class or those classes of the shareholders by whom such a loss, according to the constitution of the company, should be borne.⁴ Thus, where preferred shareholders are entitled to priority both in respect to dividends and capital, a loss of capital should be borne by the common shareholders to the relief of the preferred, and consequently upon any resulting reduction of nominal capital the loss should first be met by the common shares, even to the extent of their utter extinction.⁵ But where preferred shares have no priority in respect to capital, it would seem that the whole loss should not be thrown upon the common stock.⁶ On the other hand, where preferred shareholders were

¹ *Re Abstainers, etc. Insurance Credit Assurance, etc. Corp.* (1902), Co. (1891), 2 Ch. 124. 2 Ch. 601.

² *Barrow Haematite Steel Co.* (1900), 2 Ch. 846 (affirmed on another ground in (1901) 2 Ch. 746). ⁵ *Floating Dock, etc. Co.* (1895), 1 Ch. 691; *London & N. Y. Investment Co.* (1895), 2 Ch. 860; *Poole v. National Bank of China* (1907), A. C. 229 (headnote inadequate).

³ *Hoare & Co.* (1904), 2 Ch. 208.

⁴ *Floating Dock, etc. Co.* (1895), 1 Ch. 691; *London & N. Y. Investment Co.* (1895), 2 Ch. 860.

⁶ Cf. *Quebrada Ry. Co.*, 40 Ch. D. 363 (explained in *Re Denver Hotel Co.* (1893), 1 Ch. 495, 502); *Union*

Cf. *Hyderabad Corp.*, 75 L. T. 23;

entitled to a dividend of five per cent before any dividend should be paid to deferred shareholders and were also entitled to share *pro rata* with the deferred shareholders in any dividends in excess of five per cent and in any distribution of capital on a winding-up, a scheme was sanctioned for the cancellation of enough of the deferred shares (the holders consenting) to correspond with a loss of capital, with the proviso that the remaining deferred shares should thereafter rank in all respects *pari passu* with the preferred shares.¹ When the preferred shares have no voting rights, although they are entitled to a preference both as to capital and dividends, it has been thought not unfair that the preferred shares should bear part of the loss rather than that the deferred shares should be wholly extinguished.² Moreover, the fact that the company's regulations provide that, in the event of a deficiency of assets in winding-up, the assets shall be distributed among the several shareholders in proportion to the amounts paid up on their respective shares, does not require that the same principle should be applied, in case of a reduction of capital in consequence of losses, between shares of the same class upon which different amounts had been paid up.³

§ 657. **Wiping out illegal Over-capitalization.** — An illegal over-capitalization, it has been held, cannot be wiped out by means of the machinery provided for reducing capital. For instance, if shares are improperly issued at a discount, or if a statute requiring payment therefor in cash has not been complied with, the holders are liable to pay to the company the full par value of their shares, and this obligation cannot be escaped by an attempt to cancel that proportion of the shares represented by no actual capital.⁴ If, however, the shares had passed to

Plate Glass Co., 42 Ch. D. 513; *Ban-* *Roberts-Wicks Co.*, 184 N. Y. 257;
natyne v. Direct Spanish Tel. Co., 34 77 N. E. 13.

Ch. D. 287; *Re Barrow Haematite* ¹ *Hyderabad Co.*, 75 L. T. 23.

Steel Co., 39 Ch. D. 582; *Barrow* ² *Cf. Allsop & Sons*, 51 W. R. 644
Haematite Steel Co. (1900), 2 Ch. (headnote inadequate).

846, 855-856 (affirmed on another ³ *Credit Assurance, etc. Corp.*
ground in (1901) 2 Ch. 746, and com- (1902), 2 Ch. 601.

mented upon by Lord Macnaghten ⁴ *Re New Chile Gold Mining Co.*,
in *Poole v. National Bank of China* 38 Ch. D. 475.

(1907), A. C. 229, 238); *Roberts v.* *Cf. Re Omnium Investment Co.*

purchasers for value without notice of the circumstances attending the issue, or if for any other reason the amount actually due on the shares cannot be recovered from the holder, this reasoning would not apply; and in that case, presumably, the "water" in the shares could be "squeezed out" under the guise of a reduction of capital under the statutory procedure.

§ 658. **Reduction in order to return to Shareholders assets which Corporation had no Power to hold.** — Where a company has taken in payment for its shares assets which the courts afterwards decide to be illegal for it to hold, a statutory form for the reduction of capital may be used to reduce the capital in an amount equal to the value of those assets, which may thereupon be distributed *pro rata* among all the shareholders without making any attempt to return to each shareholder the particular assets which he had contributed in payment for his shares.¹

§ 659. **Reduction of Capital as Substitute for Winding-up Proceedings.** — The procedure for reducing capital cannot be used as a substitute for winding-up proceedings: thus, where the company had for five years done no business, a scheme for returning to the shareholders all of its property with the exception of one lot of ground which could not then be advantageously sold will not be approved as a reduction of capital.²

§ 660–§ 668. **WHETHER REDUCTION OF NOMINAL CAPITAL SHOULD BE ACCOMPANIED BY CORRESPONDING REDUCTION OF ACTUAL CAPITAL AND VICE VERSA — DISTRIBUTING AMOUNT BY WHICH THE CAPITAL IS REDUCED AMONG THE SHAREHOLDERS.**

§ 660. **Statement of the Problem.** — It has been stated above that, at least according to the better view, a reduction of capital when authorized by statute may consist either in a reduction

(1895), 2 Ch. 127; *Theis v. Durr*, 66 N. J. Eq. 274. Cf. *Lovelace v.* 125 Wisc. 651; 104 N. W. 985; 110 *Anson* (1907), 2 Ch. 424 (relating to Am. St. Rep. 880; 1 L. R. A., n. s., 571. the consequences of this transaction).

¹ *Continental Securities Co. v.* ² *Re Wallasey Brick & Land Co., Northern Securities Co.*, 57 Atl. 876; 63 L. J. Ch. 415.

of actual capital, whether in the form of paid-up capital or of liability for unpaid capital, or in a reduction of nominal capital. It remains to consider when a reduction of nominal capital should be accompanied by a reduction of the actual capital and when it should not be, and *vice versa*. The problem generally comes up for decision when a question is made whether a reduction of nominal capital should be accompanied or followed by a distribution of actual capital among the shareholders.

§ 661. **Of the Doctrine that Reduction must not destroy Equilibrium of Balance sheet.** — It would seem that in every case the effect of the reduction of capital should be such "as not to affect the equilibrium of the balance sheet to the prejudice of the creditor." In other words, if the nominal capital be regarded as a liability of the company, and if the assets be placed on the opposite or credit side of the balance sheet, every scheme of reduction should result in striking off an equal amount from both sides of the balance sheet. For instance, "where capital is written off as lost or unrepresented by available assets, the equilibrium of the balance sheet is maintained by striking out on the one side a certain amount from the paid-up capital, and on the other side a certain amount from the value of the assets. Where capital is returned as in excess of the wants of the company, an amount is in the same manner taken off from both sides of the balance sheet. The balance item on the debit or credit side of the balance sheet, as the case may be, is in either case unaffected."¹ Hence, the court concluded that a scheme of reduction which involved a diminution of nominal capital, thereby striking off a certain amount from the debit side of the balance sheet, should not be sanctioned by the court unless an equivalent amount were to be struck off from the credit side either by a return of paid-up capital or by a cancellation of liability for unpaid capital.² So, also, a scheme of reduction which involves no return of paid-up capital and no release of liability for unpaid capital will not meet with judicial approval unless a loss of capital be proved.³

¹ *Anglo-French Exploration Co.* (1902), 2 Ch. 845, 853, per Buckley J. See, however, adverse criticism of this case by Lord Macnaghten in *Poole v. National Bank of China* (1907), A. C. 229, 238-239.

² *Anglo-French Exploration Co.* (1902), 2 Ch. 845.

³ *Barrow Haematite Steel Co.* (1901), 2 Ch. 746. See, however, *supra*, § 654.

§ 662-§ 668. *Whether and to what Extent Reduction of Nominal Capital should be accompanied or followed by Distribution of Paid-up Capital among Shareholders.*

§ 662. **When such Distribution should not be made.** — There is no rule that upon a reduction of capital an amount equal to the difference between the nominal capital before and after reduction must be distributed among the shareholders, but the amount, if any, so distributable depends upon extraneous considerations which are not necessarily apparent on the face of the proceedings by which the reduction is accomplished.¹ For example, if the reduction takes the form of a mere reduction of nominal capital in order to enable the company to write off a loss or impairment, without any corresponding reduction of actual capital, there will of course be no occasion for a distribution of capital among the shareholders; and indeed any such distribution would be unlawful,² for the law does not permit a return of actual capital to the shareholders in consequence of a reduction of nominal capital unless the company would after such return continue to have assets at least equal in value to the nominal capital as reduced.³ In such a case of reduction of nominal capital for the purpose of writing off a loss or impairment of capital, the reduction affects the nominal capital only, and there is no corresponding reduction of either form of actual capital. As was said by Sir George Jessel, the actual capital has already suffered a corresponding reduction "by a very unpleasant process."⁴ So, also, if the reduction were accomplished by a cancellation of a liability attaching to partly paid shares, without any reduction of paid-up capital, no distribution of moneys representing paid-up capital need or could legally ensue; for the reduction of actual capital corresponding to the reduction of nominal capital takes place automatically, consisting merely in a relief from liability. So when a reduction is effected

¹ *Strong v. Brooklyn Cross-Town R. R. Co.*, 93 N. Y. 426. 30 N. E. 893; *Jerome v. Cogswell*, 204 U. S. 1, 7 (semble).

² Cf. *Strong v. Brooklyn Cross-Town R. R. Co.*, 93 N. Y. 426; *McCann v. First Nat. Bank*, 112 Ind. 354; 14 N. E. 251; *McCann v. First Nat. Bank*, 131 Ind. 95; ³ *Kassler v. Kyle*, 65 Pac. 34; 28 Colo. 248. ⁴ *Ebbw Vale Steel, etc. Co.*, 4 Ch. D. 827, 832.

by purchasing and extinguishing some of the outstanding shares, the reduction need not be accompanied or followed by any distribution or payment of capital moneys to the other shareholders; for in such a case, although there is a reduction of nominal capital and a corresponding reduction of actual capital, yet by reason of the method of reduction, the entire amount by which the actual capital is diminished is payable to the holders of the purchased shares and is not distributable *pro rata* among all the shareholders.

§ 663. **When the Distribution should be made.** — On the other hand a reduction of capital must sometimes be accompanied or followed by a distribution of capital moneys among the shareholders *pro rata*.¹ Thus, where a reduction of nominal paid-up capital is effected by cancelling a certain proportion of each shareholder's shares on the ground that the company's actual capital is in excess of its needs, the company must distribute assets, or their value, to the extent of the reduction among the shareholders *pro rata*: there is no power in the company to retain as a so-called surplus any portion of the actual capital which represents the nominal capital extinguished by the reduction.² But in order to justify such distribution, there must be proof that the original capital had not been in any degree impaired; for if the reduction was intended, in part to wipe out an over-capitalization or to reduce the nominal so as to correspond with the actual capital, and in part to diminish the actual as well as the nominal capital, a division of actual capital among the shareholders would be lawful only in so far as the wiping out of the over-capitalization leaves surplus capital in the company's hands in excess of the nominal capital as reduced.³

¹ As to the application of the 400 (affirmed short, 78 N. Y. Statute of Limitations to such a claim for a return of capital, see *Artisans' Land & Mortgage Co.* (1904), 1 Ch. 796. 600).

Cf. *Cogswell v. Second Nat. Bank*, 78 Conn. 75; 60 Atl. 1059, affirmed *sub nom. Jerome v. Cogswell*, 204 U. S. 1.

As to interest on a claim for return of capital set free by reduction proceedings, see *Mustard v. Union Nat. Bank*, 86 Me. 177 (holding that interest does not run until demand).

² *Strong v. Brooklyn Cross-Town R. R. Co.*, 93 N. Y. 426; *McCann v. First Nat. Bank*, 112 Ind. 354; 14 N. E. 251; *McCann v. First Nat. Bank*, 131 Ind. 95; 30 N. E. 893.

Cf. *Roberts v. Roberts-Wicks Co.*,

³ *Seeley v. New York Nat. Exchange Bank*, 8 Daly (N. Y.), 184 N. Y. 257. 102 N. Y. App. Div. 118, reversed,

§ 664. **Time of making Distribution.** — It would seem clear that in cases where, upon a reduction of capital, paid-up capital is to be returned to the shareholders, the distribution may properly follow rather than precede the final confirmation of the reduction.¹

§ 665. **Manner of Distribution — In Kind or in Cash — Distribution of Bonds.** — Where in consequence of a reduction of capital, capital is to be returned to and distributed among the shareholders, the company may distribute in kind the assets which after the reduction is consummated becomes superfluous;² but such distribution in kind is not necessary, for in lieu thereof the company may, and generally does, sell the surplus assets and convert them into cash for convenience of distribution. If this course is for any reason not deemed advisable, the company may, it would seem clear, borrow on mortgage bonds or otherwise the requisite amount of cash for distribution, thus in effect converting capital stock into bonds or obligations of the company to the extent of the reduction of capital,³ although in a Missouri case this procedure was held illegal for reasons that are not perhaps altogether convincing.⁴ Moreover, it has been held that a scheme of reduction involving the return of paid-up capital to the shareholders may provide that the company shall issue its debentures in part payment to such shareholders as elect to receive the same in lieu of cash, such a conversion of shareholders into creditors not rendering illegal a scheme otherwise unobjectionable.⁵

¹ *Lees Brook Spinning Co.* (1906), in the principal company as an authorized investment are not necessarily authorized to retain the distributed shares as an investment. 2 Ch. 394, disapproving *Calgary & Edmonton Land Co.* (1906), 1 Ch. 141.

² *Continental Securities Co. v. Lovelace v. Anson* (1907), 2 Ch. *Northern Securities Co.*, 57 Atl. 876; 424. 66 N. J. Eq. 274; *Harriman v. Northern Securities Co.*, 197 U. S. 244, 299; 25 Sup. Ct. 493.

That in such cases there is no implied warranty of title on the part of the company, see *Olsen v. Homestead Land Co.*, 87 Tex. 368; 28 S. W. 944.

If the assets so distributed in kind consist of shares in other corporations, trustees who hold shares

³ *Berger v. U. S. Steel Corp.*, 63 N. J. Eq. 809; 53 Atl. 68.

⁴ *Coquard v. St. Louis Cotton, etc. Co.*, 7 S. W. Rep. 176 (Mo.).

Cf. *Strong v. Brooklyn Cross-Town R. R. Co.*, 93 N. Y. 426.

⁵ *Re Nixon's Navigation Co.* (1897), 1 Ch. 872; *Re Lamson Store Service Co.* (1897), 1 Ch. 875 n.

Cf. *Berger v. U. S. Steel Corp.*, 63 N. J. Eq. 809; 53 Atl. 68.

§ 666. *Whether Reduction of Nominal Capital for purpose of writing-off Assets believed to be worthless casts Title to those Assets on Shareholders individually.* — If capital is reduced in an amount equal to the loss supposed to have been sustained by the deterioration of an asset which is believed to have become quite worthless, the supposedly valueless asset does not, merely in consequence of the reduction, devolve upon the shareholders individually, and if the asset in question afterwards becomes valuable and is sold by the company, a shareholder cannot force a distribution of the amount so realized among the several members of the company.¹ If, however, capital is reduced for the purpose of writing off assets of doubtful value, which are set aside as a special fund, such action is deemed equivalent to the declaration of a dividend equalling in the aggregate the value of those assets, so that upon the winding-up of the company the amount realized from the assets so reserved and set apart is distributable among those persons who were shareholders at the time the reduction was effected and the assets so set apart, and not among those who were shareholders when the company came to be wound up.²

§ 667. *Whether Moneys distributed on Reduction of Capital are Income or Capital. — Rights of Preferred and Common Shareholders, of Tenants for Life and Remaindermen.* — The amount liberated by a reduction of nominal capital for distribution among the shareholders is capital in every sense of the word. Hence, where the company has issued cumulative preferred shares which are entitled to no preference as to capital, the amount distributed among the several shareholders in consequence of a reduction of nominal capital is not to be regarded as profits available for payment of cumulative preferred dividends which were overdue at the time of the reduction but should be distributed *pro rata* among both common and preferred shareholders.³ So, an amount so distributed is to be re-

¹ *McCann v. First Nat. Bank*, of a stock dividend must be treated 112 Ind. 354; 14 N. E. 251; *McCann* as capital and not income as between *v. First Nat. Bank*, 131 Ind. 95; 30 life tenant and remainderman). N. E. 893.

² *Jerome v. Cogswell*, 204 U. S. 1 (affirming *Cogswell v. Second Nat. Bank*, 78 Conn. 75; 60 Atl. 1059).
³ *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257; 77 N. E. 13.
 Cf. *Parker v. Mason*, 8 R. I. 427 (holding that the amount of the increased value of the supposedly worthless asset when distributed among the shareholders in the form

garded as capital and not income as between tenant for life and remainderman.¹

§ 668. **Certificates issued to Shareholders on Reduction of Capital in lieu of immediate Distribution of Cash or Property.** — Where the capital of a company is reduced by cancelling certain shares and repaying to the holders the value thereof, certificates issued to the holders of the cancelled shares stating that they are entitled to so much cash from the company are regarded, it seems, as *quasi* negotiable. Hence, an assignee of such a certificate will be preferred to the company claiming under a pledge to it made by the original holder after the assignment but before notice thereof had been communicated to the company.²

§ 669. **Reduction as affecting Voting Rights of Shareholders.** — It is no objection to a proposed reduction of capital that the voting rights of the shareholders will be affected thereby.³ For instance, where in consequence of a loss of capital it was proposed to reduce the par value of the ordinary shares and to cut down proportionately their voting rights, leaving untouched the number, par value, and voting rights of the preferred shareholders, the scheme of reduction was after objection sustained.⁴ Indeed, if the par value of some only of the shares is reduced, or, presumably, if for any other reason the reduction of capital renders equitable a change in the voting rights attaching to some of the shares, the reduction will not be legal unless such change is made.⁵

§ 670. **Agreement to exercise Power of Reduction by Redeeming certain Shares.** — It is competent for a corporation to contract with the holders of certain shares to exercise its statutory power of reducing its capital by redeeming such shares at par out of accumulated profits; and where such a contract is incorporated in the incorporation paper, or original constitution of the company, the reduction of capital involved does not include a return of paid-up capital within the meaning of a statute requiring the

¹ *Infra*, § 1393.

⁴ *James Colmer, L't'd* (1897), 1

² *Callanan v. Edwards*, 32 N. Y. Ch. 524.
483.

⁵ *Pinkney & Sons S. S. Co.* (1892),

³ *Allsop & Sons*, 51 W. R. 644. 3 Ch. 125.

assent of creditors to any reduction of capital involving such a return.¹

§ 671. **Agreement not to reduce Capital or not to affect certain Shares by the Reduction.** — It seems to be conceded that just as a corporation or its shareholders may agree to prefer certain shares in the payment of dividends, so a contract that any reduction of capital shall not affect certain shares is competent.² Such an agreement should be distinguished from an attempt by a corporation to contract itself wholly out of its statutory power of reducing its capital, which would probably be nugatory.³

§ 672—§ 674. *Preferred Shares as affected by Reduction of Capital.*

§ 672. **In general.** — The mere issue of preferred shares carrying a right to a preferential dividend at a fixed rate does not amount to a contract by the company not to reduce the nominal value of such shares and thus indirectly diminish their dividends.⁴ Thus, where preferred shares are expressed to carry a preferential dividend of, say, ten per cent, the meaning is ten per cent on the par value of the shares as originally issued or as subsequently legally reduced; and the subscriber takes subject to the statutory power of reduction.⁵ So, where the preferred shareholders are entitled to “a fixed dividend of eight per cent on the amount paid up in respect of their shares” if a loss of capital is sustained, the par value of the shares may be reduced and with it the amount of the preferential dividend, since the language quoted is construed to mean that the fixed dividend shall be eight per cent on the par value for the time being of the shares and shall not exceed the same percentage on the amount which has been paid in on the shares.⁶ That the preferred shareholders have no voting rights does not restrict the company’s right to reduce their shares.⁷ Moreover, a scheme

¹ *Re Dido Pier Co.* (1891), 2 Ch. *Haematite Steel Co.*, 39 Ch. D. 354. As to redeemable shares, see 582.

also *supra*, § 225.

² *Hyderabad Co.*, 75 L. T. 23, 26.

⁵ *Bannatyne v. Direct Spanish Tel. Co.*, 34 Ch. D. 287.

³ *Barrow Haematite Steel Co.*, 39 Ch. D. 582, 596.

⁶ *Re Barrow Haematite Steel Co.*, 39 Ch. D. 582, 600–602.

⁴ *Bannatyne v. Direct Spanish Tel. Co.*, 34 Ch. D. 287; *Re Barrow*

⁷ *Re Barrow Haematite Steel Co.*, 39 Ch. D. 582, 603.

by which some of the deferred shares, with the consent of the holders, should be cancelled and the remainder of them should thenceforward rank *pari passu* with the preferred shareholders, has been upheld.¹ *A fortiori*, where the incorporation paper, after fixing the relative rights of preferred and ordinary shares, expressly provides that the company may alter the rights as so fixed, a scheme of reduction of capital which very seriously affects the rights of the preferred shareholders may nevertheless receive judicial approval, especially where a majority of the preferred shareholders assent.²

§ 673. **In case of Reduction for purpose of writing-off Lost Capital.** — The question whether a reduction of nominal capital for the purpose of writing-off a loss of actual capital should throw the loss upon the preferred shares or upon the common or ordinary shares has been considered above.³

§ 674. **Whether Reduction affects overdue cumulative preferential Dividends.** — Where cumulative preferred shares are reduced in par value with the holder's consent, it was held by the Appellate Division of the New York Supreme Court that the full amount of preferential dividends which were overdue at the time of the reduction could not be claimed by preferred shareholders before dividends are paid upon the common or ordinary shares out of subsequent earnings, but that the most that could be claimed was the preferred dividends calculated with reference to the par value of the shares as reduced.⁴ This result was reached by assimilating the case to a purchase by the company of a certain proportion of the shares; but it is submitted that the reduction is very different from such a purchase, and consequently the Court of Appeals, reversing the decision of the Appellate Division, held that the reduction ought not to be construed as affecting the preferred shareholder's vested right to the cumulative preferential dividends which were overdue at the time of the reduction.⁵ Such should certainly be the construction if the reduction were effected without the shareholder's assent; and it is submitted that even an express assent should be taken most strongly in favor of the shareholder, and should not be held

¹ *Hyderabad Co.*, 75 L. T. 23.

⁴ *Roberts v. Roberts-Wicks Co.*,

² *Welsbach Incandescent Gas Light Co.* (1904), 1 Ch. 87.

⁵ *Roberts v. Roberts-Wicks Co.*, 184 N. Y. 257; 77 N. E. 13.

³ *Supra*, § 656.

equivalent to a waiver of existing vested rights unless clearly intended to have that effect. Indeed, according to the opinion of the New York Court of Appeals it would seem that no exercise of the statutory power of reduction could legally without the consent of the preferred shareholders affect their vested right to the overdue preferential dividends even if clearly intended according to its terms to have that effect.¹

§ 675-§ 677. *Modification of Capital otherwise than by Increase or Reduction — Consolidation and Subdivision of Shares.*

§ 675. **Whether Corporation may Consolidate or Subdivide its Shares.** — Inasmuch as the number and par value of the shares into which the capital of a corporation is divided is almost always stated in the incorporation paper, or in the company's special act, the consolidation or subdivision of the shares by the company will be illegal unless legislative authority for the change can be shown.² Even an express power reserved in the incorporation paper to reduce or subdivide the shares would be ineffective in the absence of legislative sanction therefor.³ A subdivision of shares has more serious consequences than a consolidation of shares; for, if the company might subdivide the shares indefinitely, they might be reduced to so small an amount and scattered among so many holders that no one shareholder would owe a sufficiently large sum to justify the expense of collection, and thereby creditors of the company might be prejudiced.⁴ Where, however, the special act of incorporation does not fix the number of the shares into which the capital should be divided, the company, it seems, may alter the number at pleasure, although no such alteration can affect the members' substantive rights, — such as their voting rights.⁵

¹ See, however, *Oban & Aultmore-Glenlivet Distilleries*, 5 Fraser (Sc.), 1140.

⁴ *Financial Corporation*, 2 Ch. 714, 733, per Lord Cairns.

² *Financial Corporation*, 2 Ch. 714; *Tschumi v. Hills*, 6 Kans. App. 549; 51 Pac. 619.

⁵ *Ambergate, etc. Ry. Co. v. Mitchell*, 4 Ex. 540. Cf. *Somerset, etc. R. R. Co. v. Cushing*, 45 Me. 524.

³ *Financial Corporation*, 2 Ch. 714.

§ 676. **Consolidation or Subdivision of Shares under Statutory Authority.** — Sometimes general incorporation laws authorize a consolidation or subdivision of shares. Sometimes this is effected upon an increase or reduction of capital, the old shares being virtually surrendered and new shares to the amount of the capital as increased or reduced being issued.¹ An alteration in the par value of shares, even when accomplished under sanction of law, will not have a retroactive effect so as to change the meaning of contracts or offers previously made with or to the company. For example, when a person applied for shares in a corporation, the shares being then of the nominal value of £20, a subsequent change in the par value of the shares from £20 to £40 could not enable the company by accepting the offer to require the applicant to take £40 shares; but on the contrary the company's acceptance completed a contract for the issue of £20 shares.²

§ 677. **Effect of unauthorized Consolidation or Subdivision.** — An unauthorized or illegal attempt at subdivision or consolidation of shares is wholly nugatory; the shares remain of the original amount. For example, where a company attempted to divide its shares of £100 each into shares of the nominal value of £20 each, giving certificates for five £20 shares in exchange for each £100 share, the shares remained of the nominal value of £100 each; a transfer of five £20 shares operated as a transfer of the £100 share for which they had been given in exchange, so long as the origin of the new shares could be traced; and the transferee although entered on the register as a holder of five £20 shares and although ignorant of the fact that the shares had been originally of the denomination of £100 is nevertheless liable as the holder of a £100 share.³ In such a case, a proceeding for the forfeiture of the shares for non-payment of calls, treating them as £20 shares, would be irregular and liable to be set aside if the objection be seasonably made; but if the shareholder raises no such point, but on the contrary asks for a remission of the forfeiture as a matter of grace, he thereby waives the point, and the company or its liquidator cannot hold him for subsequent calls as if the for-

¹ See *Gettysburg Nat. Bank v. Brown*, 95 Md. 367; 52 Atl. 975.

² *Gustard's Case*, 8 Eq. 438.

³ *Financial Corporation*, 2 Ch. 714. Cf. *Cammack v. Levy* (La.), 45 So. 925.

feiture were void.¹ In a Kansas case, where the directors without legal authority undertook to increase the par value of the shares, it was held that a person who had accepted a certificate for shares of the increased value incurred no liability as shareholder.²

¹ *Financial Corporation* (King's Case), 2 Ch. 714.

² *Tschumi v. Hills*, 6 Kans. App. 549; 51 Pac. 619.

CHAPTER XII

BY-LAWS AND INTERNAL REGULATIONS

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§ 678. **The Need of Internal Regulations adapted to each Com-
pany's peculiar Conditions.** — Regulations of some sort for the
government and management of corporations, in addition to the

rules laid down by the incorporation statute or companies act, are almost a necessity. The incorporation paper, containing as it generally does the mere skeleton of the company's constitution, cannot adequately supply this want; and besides, being alterable with difficulty or not at all, it cannot be adjusted to meet the changing needs of the company's business. In the case of companies incorporated by special act, the desirability of some method of establishing for themselves rules and internal regulations was by no means so great as in the case of companies organized under general laws. For a special act of incorporation could, and often did, provide many details for the management of the company that were supposed to be especially adapted to its own peculiar needs. But a general incorporation law, providing as it does for an indefinite multitude of corporations whose individual circumstances and wants cannot be foreseen, is necessarily incapable of furnishing a satisfactory code of regulations for each one of them. Then, too, unless the freedom of the right to incorporate is to be delusive, each company should have liberty to frame its own regulations. As an experienced English author has said: "Companies and their members cannot be expected to put up with a uniform set of regulations, any more than testators with a common form of will, or partners in firms with a common form of partnership deed. A company with hundreds or thousands of members obviously may require very different regulations to those required by one with only a dozen or a few dozen members."¹

§ 679. **By-laws as Internal Regulations.** — The only means by which in the United States under the present laws a corporation can establish rules for its management subordinate to its incorporation paper is through the instrumentality of by-laws.² This system of corporate government by by-laws originated with the old common law corporations erected by royal charter; and

¹ Palmer's Introductory Note to *Lodge v. Kutscher*, 179 Ill. 340; 53 Revised Table A (Supplement to N. E. 620; 70 Am. St. Rep. 115; Palmer's Company Precedents, 9th ed.), p. 5.

² The so-called "constitutions" of some American corporations, particularly benevolent and social organizations, are in legal contemplation nothing but by-laws. *Supreme*

although the system in its original form is now obsolete in England so far as ordinary business corporations are concerned, having been superseded by a newer if not a better, yet it has survived in America. The power to enact by-laws was incident to every corporation at common law; and the same power may be implied in the case of our American statutory corporations.¹

§ 680. **Objections to By-laws as Regulations for Modern Companies.** — One might easily demonstrate the extremely unsatisfactory nature of by-laws, such as might be enacted by a corporation at common law, as a subordinate constitution, or code of permanent regulations, for a modern business company. Indeed, objections to corporate government through by-laws may be found in every direction as the subject is investigated. As by-laws may be either in writing or parol, either recorded in the minutes or not so recorded, as they may either originate in express vote of the company or be implied from a custom, their very existence is often uncertain. Even a lawyer will often be in doubt whether a particular regulation is in force as part of the by-laws or not. All the circumstances combine to beget in the shareholders utter disrespect and disregard for their by-laws. Very often no by-laws are adopted, and generally those that are adopted are not observed.

§ 681. **Remedies attempted by Legislatures in America.** — Attempts to remedy this unfortunate condition have been made in some of the United States. Thus, by-laws are sometimes required to be in writing or to be adopted by a two-thirds vote. Sometimes they have been required to be under the corporate seal.² These expedients are but palliative, however; for no adequate relief can be had unless the by-laws are, like the incorporation paper, required to be recorded in a public registry, so as not merely to invest them with some formality and title to respect, but also to charge the shareholders and all who deal with the company with constructive notice of them. So far as the writer is aware, this course has not become general anywhere in the United States.³

¹ *Martin v. Nashville Bldg. Ass'n*, 2 Coldw. (Tenn.) 418 (semble).

² Compare, however, *Fee v. Nat. Masonic Accident Ass'n*, 110 Iowa

³ *Dunston v. Imperial Gas Light Co.*, 3 B. & Adol. 125; *McDonnell v. Ontario, etc. R. R. Co.*, 11 Up. Can. Q. B. 267. 271; 81 N. W. 483; *Allman v. Havana, etc. R. R. Co.*, 88 Ill. 521, 23 (as to Illinois Railway Law of 1872); *Rose Hill, etc. Road Co. v.*

§ 682. **Remedy in England — Articles of Association.** — In England, on the other hand, although the power of enacting by-laws was and is incident to every corporation created by royal charter, yet the Companies Acts beginning with the act of 1856, substitute, as to companies incorporated under them, a different system. As we have already stated, each English company, in addition to its memorandum of association or incorporation paper, has its articles of association, which comprise the matters of internal regulation proper to be relegated to mere by-laws.¹ These articles must be executed by the subscribers to the memorandum and recorded contemporaneously with that document in the registry of joint-stock companies. If no articles are adopted, the code of internal regulations contained in "Table A"² is to apply in lieu thereof. The company's articles, or "Table A" if no articles are adopted, are subject to alteration by a special resolution — that is to say, a resolution which is passed by a three-fourths vote at a general meeting convened for the purpose, and which is confirmed at another general meeting held after an interval of not less than a fortnight nor more than a month.³ Any such special resolution must, like the original articles, be recorded in the registry.⁴

§ 683. **Comparison between English Articles and American By-laws.** — These articles of association of an English company take the place of by-laws, and are in substance and effect recorded by-laws;⁵ but they are never in England called by that name. The differences between them and the by-laws customary in the United States are due almost entirely to the greater formality attending their adoption and the fact that, as they are recorded, all who deal with the corporation must at their peril take notice of them.⁶ Thus, a consequence of the formal

People ex rel. Lawless, 115 Ill. 133; *Manon Insurance Co.* (1902), A. C. 3 N. E. 725. 232.

¹ *Supra*, § 11.

² See *supra*, § 12.

³ Companies Act, 1862, § 50-§ 51.

⁴ *Ibid*, § 53.

⁵ See *Brown v. Republican Silver Mines*, 55 Fed. 7 (where the articles of association of an English company were consistently denominated by-laws by the court); *Ho Tung v.*

As to the function of English articles, see further *supra*, § 11.

⁶ *Mahony v. East Holyford Mining Co.*, L. R. 7 H. L. 869, 893, where Lord Hatherley said: "It is a point of very great importance that those who are concerned in joint-stock companies and those who deal with them should be aware of what is essential to the due performance of

nature of English articles of association and of the fact that they are made matter of record and accessible to the public is that they may reasonably enough deal with matters that could not be left to the informal, unrecorded American by-laws without injustice.¹ Subject to these qualifications, it is apprehended that English articles and American by-laws should be affected by the same considerations.

§ 684. **Regulations — Meaning of Term.** — A term which is often used to denote the articles of association of an English company and may with equal propriety be applied to the by-laws of an American corporation is “regulations.” Accordingly, it will be used in this work to denote both the one and the other. Indeed, the word properly designates any rules for the company’s constitution and management which are binding upon its members. Accordingly, it might fairly be taken to include the incorporation paper; but in a recent case the word “regulations” in a British statute was construed to refer exclusively to the articles of association and not to the memorandum or incorporation paper.² In its usual sense, the word regulations is ordinarily to be taken to mean conventional regulations as distinguished from regulations prescribed by statute; and yet even the latter are sometimes designated by the term.

§ 685-§ 687. *Nature of By-laws.*

§ 685. **Scant consideration of subject by Judges and Text-writers.** — Any one who bears in mind the important part in the corporate economy that is played, in theory at least, by the by-laws, will be no little surprised to see how scant has been the consideration of their real nature either by courts or text-writers.

§ 686. **Municipal Ordinances as Examples of By-laws.** — Perhaps the most instructive and typical instances of by-laws can be

their duties, both as customers or pany, and those who so deal with dealers with the company and as them must be affected with notice of persons forming the company, and all that is contained in those two dealing with the outside world re documents.”

respectively. . . . Every joint-stock company has its memorandum and ¹ See *McKain and Canadian Birbeck, etc. Co.*, 7 Ont. L. R. 241, 246-247.

articles of association . . . are open ² *Dexine Patent Packing & Rubber Co.*, 88 L. T. 791.
to all who are minded to have any
dealings whatsoever with the com-

found in the by-laws of municipal corporations — that is to say, in municipal ordinances. Such municipal by-laws are, as their name implies, laws. When valid and authorized by the charter, they have all the force of law. In the case of modern business corporations, although the power of making by-laws is much more limited and although the means for their enforcement are much less perfect, yet their real nature as laws is the same. To be sure, ordinances of municipal corporations are local laws and bind all persons within the territorial limits of the municipality, whereas by-laws of ordinary business corporations bind only members and officers; but this distinction goes to the extent of the jurisdiction of the corporation rather than to the real nature of the by-laws. The kinship of the by-laws of ordinary industrial corporations to the ordinances or by-laws of a municipality is demonstrated by the case of the incorporated guilds of merchants and craftsmen which became common in England in the sixteenth century and which are in some respects the antetypes of the American corporations of to-day. These societies would legislate for their members in much the same way as a common council of an incorporated town legislates for its inhabitants. They would prohibit unworkmanlike practices, and enact rules of sundry sorts for the conduct of the trade.

§ 687. **Distinction between By-laws and mere Resolutions.** — In essence, however, by-laws are mere resolutions of the corporation. They are distinguished from other resolutions “in that a resolution applies to a single act of the corporation, while a by-law is a permanent and continuing rule, which is to be applied on all future occasions.”¹

§ 688–§ 690. *Method of adopting By-laws.*

§ 688. **In general — By-laws resting in Parol — Custom as By-law.** — Inasmuch as by-laws are nothing but resolutions of the corporation, the method of adopting them may be characterized

¹ 1 Cook on Corporations, 4th ed., Barb. (N. Y.) 508, 539–540; *Dornes* § 4 a; *Steger v. Davis*, 8 Tex. Civ. v. *Supreme Lodge*, 75 Miss. 466, 480–App. 23; 27 S. W. 1068. 481; 23 So. 191; *Sorrentino v. Cil-*

Cf. *North Milwaukee Town Site letti*, 75 N. Y. App. Div. 507; 78 *Co. v. Bishop*, 103 Wisc. 492, 493; N. Y. Supp. 322; *Walker v. John-* 79 N. W. 785; 45 L. R. A. 174; *son*, 17 App. (D. C.) 144, 163. *Drake v. Hudson River R. R. Co.*, 7

by very great informality. Indeed, it seems clear that like other resolutions by-laws need not be written or reduced to writing, but may rest in parol merely.¹ So, a custom or usage of the company may have the force of a by-law.² *A fortiori*, a written by-law or code of by-laws which has been acted upon by the company for years will be the law of the company in spite of any defect in its original adoption;³ and indeed the same rule applies to English articles of association which, without signature by the incorporators or formal adoption by special resolution, have been acted on and recognized by the company for many years and have even been amended from time to time by special resolution formally adopted.⁴ Still more clearly, a by-law which was declared to be adopted and which has been acted upon by the company for eleven years will be presumed to have received the two-thirds vote which, by the company's incorporation paper, was necessary for its adoption.⁵ So, a book of by-laws which is circulated among the members of a corporation as its regulations is admissible in evidence as the by-laws of the company without any proof of formal adoption.⁶ Moreover, where the power of enacting by-laws resides in the directors, it has been held that a

¹ *Masonic, etc. Ass'n v. Severson*, 71 Conn. 719; 43 Atl. 192 (amendment of by-law by parol unrecorded resolution); *Knights, etc. of America v. Weber*, 101 Ill. App. 488.

² *Miller v. Eschbach*, 43 Md. 1; *Mutual Fire Ins. Co. v. Farquhar*, 86 Md. 668; 39 Atl. 527; *Stafford v. Produce Exchange Banking Co.*, 16 Oh. Circ. Ct. 50; *Waln's Assignees v. Bank of N. America*, 8 S. & R. (Pa.) 73; 11 Am. Dec. 575; *Walker v. Johnson*, 17 App. (D. C.) 144, 161.

But see *District Grand Lodge v. Cohn*, 20 Ill. App. 335, 344-345.

As to custom having the effect of a by-law or regulation in the case of an English company incorporated under the Companies Acts, see *Marino's Case*, 2 Ch. 596.

As to proof of custom, see *Firestone v. First Slavish, etc. Church*, 215 Pa. 8; 63 Atl. 1038.

³ *State v. Curtis*, 9 Nev. 325; *Lockwood v. Mechanics Nat. Bank*, 9

R. I. 308; 11 Am. Rep. 253; *Union Bank v. Ridgely*, 1 H. & G. (Md.) 324, 410-414; *Frank v. Morrison*, 58 Md. 423, 438-439; *Graebner v. Post*, 119 Wisc. 392; 96 N. W. 783; 100 Am. St. Rep. 890; *Star Loan Ass'n v. Moore* (Del.), 55 Atl. 946; 4 Penn. 308.

Cf. *Myar v. Poe* (Ark.), 95 S. W. 1005 (provision in articles of association held to be a by-law within the meaning of a statute).

⁴ *Ho Tung v. Manon Insurance Co.* (1902), A. C. 232. Cf. *Muirhead v. Forth, etc. Mutual Ins. Co.* (1894), A. C. 72.

⁵ *Marsh v. Mathias*, 19 Utah 350 (headnote inadequate); 56 Pac. 1074. For further illustrations of this principle, see *Hagerman v. Ohio Bldg., etc. Ass'n*, 25 Oh. St. 186; *Morrison v. Dorsey*, 48 Md. 461.

⁶ *Knights, etc. of America v. Weber*, 101 Ill. App. 488.

mere contract entered into by the directors may have the force of a by-law.¹

§ 689. **By-laws adopted before Incorporation.** — Of course, by-laws cannot be adopted prior to the incorporation of the company; and any by-laws so adopted are invalid.² A special act incorporating a voluntary association which provides that the by-laws of the association shall be the by-laws of the corporation until repealed or altered, does not, it has been held, impart validity to any provisions in the by-laws which according to general principles of law would be invalid, but merely dispenses with the necessity of formal adoption by the corporation.³

§ 690. **By-laws adopted in Foreign States.** — It is generally held that by-laws adopted in a state other than that by which the company is incorporated are not binding.⁴ This conclusion is a necessary result of the commonly accepted doctrine in respect to the validity of corporate action taken in a foreign state, and is therefore fully treated in connection with the subjects of meetings of shareholders and directors.

§ 691-§ 692. *In whom Power of enacting By-laws resides.*

§ 691. **Whether the Power resides in the Shareholders or in the Directors.** — Generally, the power of enacting by-laws resides in the shareholders at large and not in the directorate;⁵ and this rule is not affected by a provision that "the stock, property, affairs and business" shall be under the care of and managed by the board of directors.⁶ When the power of enactment rests

¹ *Hazlehurst v. Savannah, etc. Co.*, 56 Mo. App. 145; *United Fire R. R. Co.*, 43 Ga. 13, 53.

² *Vercoutere v. Golden State Land Co.*, 116 Cal. 410; 48 Pac. 375; *Boston Acid Mfg. Co. v. Moring*, 15 Gray (Mass.) 211, 214 (semble).

³ *Albers v. Merchants' Exchange*, 39 Mo. App. 583, 592, 596-597 (headnote inadequate). But see *Heinzelman v. Druids Relief Ass'n*, 38 Minn. 138; 36 N. W. 100.

⁴ *Mitchell v. Vermont Copper Mining Co.*, 40 N. Y. Sup. Ct. 406. See *infra*, § 1212, § 1462.

⁵ *Morton Gravel Road Co. v. Wyson*, 51 Ind. 4; *North Milwaukee Town Site Co. v. Bishop*, 103 Wisc. 492; 79 N. W. 785; 45 L. R. A. 174; *Watson v. Woody Printing*

Co., 56 Mo. App. 145; *United Fire Ass'n v. Benseman*, 4 Wkly. Notes Cas. (Pa.) 1; *Carroll v. Mullanphy Sav. Bank*, 8 Mo. App. 249. The adoption of a code of by-laws by unanimous vote of all the shareholders is not, however, invalid because they are also directors, and the meeting at which the action is taken is called a meeting of directors. *State Savings Ass'n v. Nixon-Jones Printing Co.*, 25 Mo. App. 642.

⁶ *North Milwaukee Town Site Co. v. Bishop*, 103 Wisc. 492 (headnote

with the shareholders, the by-laws have the effect of binding the directors¹ and all inferior agents, so that no action taken in contravention of them can bind the company at least as against any person having notice of the by-laws. Under some incorporation laws the power of enactment is expressly reposed in the directors;² and where this is the case, there is an end of what little authority might otherwise attach to the by-laws. For the same authority that enacts may also repeal or alter³ or disregard⁴ the by-laws; and hence the by-laws do not restrain the company's own governing body, which it should be the chief object of regulations to control. By-laws enacted by the directors govern inferior agents and the individual shareholders; but as to the directors themselves they amount to nothing more than a declaration of a present intent to pursue a given course. By a strange anomaly, where the power of enacting by-laws is lodged with the directors, a by-law duly adopted by the directors will prevail over a subsequent inconsistent resolution adopted by the shareholders in general meeting assembled.⁵ Where the power of enacting by-laws resides in the shareholders, perhaps, as will hereafter be shown, they may delegate it to the directors; but a provision in the by-laws themselves that they may be amended by the directors does not enable the directors to abrogate another by-law imposing limitations on their powers.⁶

§ 692. **Dual Power in both Shareholders and Directors.** — Indeed, a power of enacting by-laws may be vested without incompatibility both in the shareholders and in the directors.⁷ That is to say, even where the power of enacting by-laws is lodged with the shareholders, the directors may always — in

inadequate); 79 N. W. 785; 45 L. R. A. 174.

¹ *United Fire Ass'n v. Benseman*, 4 Wkly. Notes Cas. (Pa.) 1; *Samuel v. Holladay*, 1 Woolw. 400, 408 (semble); *Fowler v. Great Southern Tel., etc. Co.*, 104 La. 751; 29 So. 271.

² *Hughes v. Wisconsin, etc. Ins. Co.*, 98 Wisc. 292; 73 N. W. 1015; *People v. Sterling Mfg. Co.*, 82 Ill. 457 (where the by-laws were adopted by a shareholders' meeting in which all the directors participated).

³ See *infra*, § 720.

⁴ See *infra*, § 728.

⁵ *Granger v. Grubb*, 7 Phila. (Pa.) 350 (headnote inadequate). Cf. *Manufacturers' Exhibition Bldg. Co. v. Landay*, 76 N. E. 146; 219 Ill. 168. But see *infra*, § 692.

⁶ *Stevens v. Davison*, 18 Gratt. (Va.) 819; 98 Am. Dec. 692.

⁷ Cf. *Lovell v. Westwood*, 2 Dow & Cl. 21.

subordination of course to the shareholders — make rules for their own orderly action and for the government of the company's agents. By whatever name these rules may be called, they are in their nature by-laws. Thus, in every corporation, there would seem to be in reality a dual power of adopting by-laws — a subordinate power in the directors,¹ and a controlling power in the shareholders.² Consequently, on principle, an express authority given to directors to enact by-laws should not be held to oust the shareholders of their common law power of adopting controlling regulations or by-laws for the corporation.³ So, a delegation of the power to enact by-laws by the shareholders to a select body of the members would seem to be unobjectionable;⁴ for the members at large may at any time revoke the authority and abrogate any regulations adopted by the delegates. In any corporation, however, in which the power to enact by-laws is not conferred upon the directors, no rules or regulations that the directors may adopt will be deemed by-laws within the meaning of statutes requiring certain things to be done in accordance with the by-laws. Thus, where a statute provides that such notice of calls shall be given as the by-laws shall prescribe, a call is not enforceable of which notice was given in accordance with a regulation adopted by the directors, no rule on the subject having been prescribed by the shareholders.⁵

¹ Cf. *Pfister v. Gerwig*, 122 Ind. 567, 570-571 (headnote inadequate); 23 N. E. 1041; *Heinzelman v. Druids Rel. Ass'n*, 38 Minn. 138; 36 N. W. 100; *Albers v. Merchants' Exchange*, 39 Mo. App. 583.

But see *Watson v. Woody Printing Co.*, 56 Mo. App. 145; *Carroll v. Mullanphy Sav. Bank*, 8 Mo. App. 249; in which cases regulations adopted by directors were held to be utterly void.

See also *Thayer v. Herrick*, 23 Fed. Cas. 899, where a regulation adopted by directors prohibiting the officers from selling certain property of the company was pronounced void because the power of enacting by-laws was vested in the shareholders. And compare *Supreme Lodge v. Kutscher*, 179 Ill. 340; 53 N. E. 620; 70 Am. St. Rep. 115.

² Cf. *Stephenson v. Vokes*, 27 Ont. 691. But see *Granger v. Grubb*, 7 Phila. (Pa.) 350 (headnote inadequate).

³ Cf. *Lovell v. Westwood*, 2 Dow & Cl. 21; *Stephenson v. Vokes*, 27 Ont. (Can.) 691.

But see *Manufacturers' Exhibition Bldg. Co. v. Landay*, 76 N. E. 146; 219 Ill. 168; *Dunsmuir v. Colonist Printing & Pub. Co.*, 9 Brit. Columb. 290, 293 (semble).

⁴ Cf. *Stevens v. Davison*, 18 Gratt. (Va.) 819; 98 Am. Dec. 692 (where by-laws adopted by the shareholders purported to authorize the directors to amend them).

See also *Albers v. Merchants' Exchange*, 39 Mo. App. 583; *Griffing Iron Co.*, 63 N. J. Law 168, 171; 41 Atl. 931.

⁵ *North Milwaukee Town Site Co.*

So, where a statute gives a turnpike company the power to adopt by-laws fixing rates of tolls, a schedule of rates promulgated by the directors is not binding on those who travel over the company's road.¹ Moreover, where a statute provides that by-laws adopted by the directors shall, unless confirmed by a general meeting of the company, continue in force only until the next annual meeting of the shareholders, a by-law adopted by the directors fixing a quorum for shareholders' meetings ceases to be effective after the next annual meeting unless it be confirmed by affirmative action of the shareholders.²

§ 693-§ 715. WHAT BY-LAWS OR REGULATIONS ARE VALID.

§ 693-§ 695. . *General Rules.*

§ 693. **By-laws void in Part.** — A by-law which consists of two or more distinct parts is not necessarily void *in toto* because one part of it is invalid.³ If, however, the bad portion is not separable from the rest, the whole is void.⁴

§ 694. **Void By-laws incorporated into Contracts.** — A by-law that is not valid because of some defect in its adoption, or for illegality or unreasonableness, may nevertheless be incorporated into a contract with the company and so, as to that particular transaction, have the same effect as if it were valid.⁵ Thus, where a code of by-laws which was adopted prior to the incorporation of the company and was therefore invalid contains a provision that subscriptions to shares of the capital stock should be payable in monthly instalments, a subscriber who signs the by-laws thereby agrees to pay according to the provision therein contained.⁶ A reference in a contract to the by-

v. *Bishop*, 103 Wisc. 492; 79 N. W. 785; 45 L. R. A. 174.

¹ *Morton Gravel Road Co. v. Wy-song*, 51 Ind. 4.

² *Darrin v. Hoff*, 99 Md. 491, 499-500; 58 Atl. 196.

³ *Amesbury v. Bowditch Mut. Fire Ins. Co.*, 6 Gray (Mass.) 596;

Rex v. Company of Fishermen, 8 T. R. 352, 356 (semble).

⁴ *State v. Curtis*, 9 Nev. 325; *Rex v. Company of Fishermen*, 8 T. R. 352, 356 (semble).

⁵ *Muirhead v. Forth, etc. Mutual Ins. Ass'n* (1894), A. C. 72.

Cf. *Skelly v. Private Coachmen's, etc. Soc.*, 13 Daly (N. Y.) 2.

⁶ *Vercoutere v. Golden State Land Co.*, 116 Cal. 410; 48 Pac. 375.

Cf. *Pfister v. Gerwig*, 122 Ind.

laws or regulations of the company may be construed to apply to the regulations as amended by an amendment which was never legally adopted.¹

§ 695. **Estoppel to deny Validity of By-laws.** — Certain persons or classes of persons may be estopped from questioning the validity of by-laws that would be open to attack by anybody who is free to assert the truth.² For example, a shareholder who participates in passing a by-law confiding to the shareholders the power of levying calls instead of to the directors as provided by statute is estopped from disputing the validity of a call levied by a shareholders' meeting in pursuance of the by-law.³ So, the validity of a by-law providing for the forfeiture of shares of delinquent shareholders cannot be questioned by one who although not shown to have been present when the by-law was adopted yet in company with the other shareholders acquiesced therein and accepted a share-certificate on which the by-law was printed.⁴ On the other hand, a shareholder who votes in favor of a by-law prohibiting the transfer of shares except under certain onerous conditions does not preclude himself or his transferee from treating the regulation as invalid if he be minded to transfer his shares.⁵ Moreover, a shareholder is not estopped from setting up the invalidity of a certain by-law merely because he raised no objection to it until an attempt was made to enforce it against him.⁶ The principle of the maxim, *allegans contraria non est audiendus*, may sometimes be invoked to prevent a party from disputing the validity of a by-law upon which he must rely in order to establish his title.⁷

567; 23 N. E. 1041; *Fee v. Nat. U. S. Savings, etc. Co. v. Shain*, 8 N. Masonic Accident Ass'n, 110 Iowa Dak. 136; 77 N. W. 1006; *Blue Mt. 271; 81 N. W. 483.* *Forrest Ass'n v. Borrowe*, 71 N. H.

¹ *Muirhead v. Forth, etc. Mutual* 69; 51 Atl. 670.

Ins. Ass'n (1894), A. C. 72 (a case relating to the articles of association of a British company). ² *Willamette Freighting Co. v. Stannus*, 4 Oreg. 261.

³ Cf. *Morrison v. Dorsey*, 48 Md. Ann. 316. ⁴ *Lesseps v. Architects' Co.*, 4 La.

461; *Bergman v. St. Paul, etc. Bldg. Ass'n*, 29 Minn. 275, 280-281; 13 N. W. 582. ⁵ *Re Klaus*, 67 Wisc. 401; 29

N. W. 120; *Falcone v. Societa Sarti*, 61 N. Y. Supp. 873; *People ex rel. Wallace v. Stirling Mfg. Co.*, 82 Ill. 1036. ⁶ *Kolff v. St. Paul Fuel Exchange*, 48 Minn. 215; 50 N. W.

457; *Reynolds v. Georgia State Bldg., etc. Ass'n*, 102 Ga. 126; 29 S. E. 187; *Rex v. College of Physicians*, 5 Burr. 2740, 2760-2761.

§ 696-§ 698. *By-laws and Regulations must be legal.*

§ 696. **Must not conflict with any Statute.** — The first condition to the validity of internal regulations of a corporation either in England or America is that they be legal, and do not conflict with the provisions of the statute under which the company is organized, or with any other statute that may be applicable.¹ Thus, a provision in the regulations that a shareholder shall not, except under certain conditions, exercise the right given him by statute of applying for a winding-up is invalid.² So, too, a by-law providing that at annual meetings of the company any business may be transacted whether specified in the notice of the meeting or not cannot apply to a vote to increase the capital of the company where a vote of that sort is required by statute to be taken at a meeting called for the purpose.³ Still more clearly, a by-law purporting to absolve shareholders from their statutory liability to creditors is void.⁴ A by-law attempting to authorize the company to enter into contracts which are beyond its powers as defined in its act of incorporation is of course void.⁵ Moreover, by-laws must be in harmony with the general statutes of the state. Hence, a by-law which provides for usurious interest upon advances to stockholders is void.⁶ A by-law providing for a rate of interest which at the time was legal is abrogated by a subsequent statute making so high a rate of interest usurious.⁷ Moreover, a provision in the regulations of a company that the interest of a bankrupt shareholder should not pass to his assignee in bankruptcy would contravene the bankrupt act; but on the other hand a provision that the assignee in bankruptcy must sell the shares is not obnoxious to

¹ *Great Falls, etc. Ins. Co. v. Harvey*, 45 N. H. 292. Note, however, that a by-law waiving a privilege conferred upon the corporation by statute is valid. *Dupuy v. Eastern Bldg., etc. Ass'n*, 93 Va. 460; 25 S. E. 537; 35 L. R. A. 215.

² *Peveril Gold Mines* (1898), 1 Ch. 122.

³ *Jones v. Concord & Montreal R. R. Co.*, 67 N. H. 119, 140-141 (headnote inadequate); 38 Atl. 120.

⁴ *Wells v. Black*, 117 Cal. 157; 48 Pac. 1090; 59 Am. St. Rep. 162; 37 L. R. A. 619.

⁵ *Andrews v. Union Mutual Fire Ins. Co.*, 37 Me. 256. As to by-laws for *ultra vires* purposes, see further infra, § 699-§ 701.

⁶ *Herbert v. Kenton, etc. Ass'n*, 74 Ky. 296; *Martin v. Nashville Bldg. Ass'n*, 2 Coldw. (Tenn.) 418.

⁷ *Mechanics, etc. Ass'n v. Dorsey*, 15 S. Car. 462.

that objection.¹ In determining whether or not a by-law is in conflict with a statute regard must be had to the purpose of the statute; for in some cases the legislature may have intended the statutory rule to apply only where the company's regulations are silent on the subject.²

§ 697. **Must not conflict with general Principles of Corporation Law.** — In like manner, regulations that are contrary to the spirit of the incorporation statute or to the general principles of corporation or company law — such as provisions purporting to authorize the issue of shares at a discount,³ or the payment of dividends out of capital,⁴ or the purchase by the company of its own shares,⁵ or other return of capital to the shareholders⁶ — are void. Indeed, such by-laws are in conflict with the implied, if not expressed, provisions of the incorporation act.

§ 698. **Must not conflict with Common law.** — So, also, by-laws that are contrary to any rules of the common law, that have not been abrogated by statutes, are illegal and void. Of course, this proposition does not mean that any by-law is void which lays down a rule different from that which would prevail if the regulations were silent on the subject; for if that were the case corporate regulations would never be legal except when superfluous.⁷ The doctrine is rather that any by-law or other regula-

¹ *Borland's Trustees v. Steel Brothers & Co.* (1901), 1 Ch. 279.

² The circumstances under which a by-law is deemed to conflict with the general law have been well stated by Channell, J.: "A by-law is not repugnant to the general law merely because it creates a new offence, and says that something shall be unlawful which the law does not say is unlawful. It is repugnant if it makes unlawful that which the general law says is lawful. It is repugnant if it expressly or by necessary implication professes to alter the general law of the land. . . . Again, a by-law is repugnant if it adds something inconsistent with the provisions of a statute creating the same offence; but if it adds something not inconsistent, that is not sufficient to make the by-law bad as repugnant." *Genetel v. Raps* (1902), 1 K. B. 160, 166.

³ *Welton v. Saffory* (1897), A. C. 299. Cf. *Union Savings Bank v. Leiter*, 145 Cal. 696; 79 Pac. 441.

⁴ *Guinness v. Land Corporation*, 22 Ch. D. 349.

⁵ *Trevor v. Whitworth*, 12 A. C. 409.

⁶ *Vercoutere v. Golden State Land Co.*, 116 Cal. 410; 48 Pac. 375.

⁷ Said Lord Campbell in *Edmonds v. Company of Watermen & Lightermen*, 24 L. J. Magistrate Cases 124, 128: "A by-law cannot be said to be inconsistent with the laws of this kingdom merely because it forbids the doing of something which might lawfully have been done before, or requires something to be done which there was no previous obligation to do; otherwise a nominal power of making by-laws would be utterly nugatory."

tion is void when the common law has not merely a different rule but also a different policy.¹ That is to say, in order to strike down a by-law or regulation as illegal, the law must not merely establish a different rule but must, either expressly or by implication from its general policy, provide that that different rule shall apply not only when the regulations are silent on the subject, but even in spite of by-laws or regulations to the contrary. Thus, although the common law does not permit shareholders to vote by proxy, yet a by-law authorizing voting by proxy is, according to the better view, quite valid.² So, although the common law gives each member only one vote no matter how many shares he may hold, yet a by-law allowing one vote for every share owned by the voter is valid.³ On the other hand, a by-law of a mutual benefit or insurance society attempting to exclude the application of the principle of equitable estoppel so as to prevent an estoppel to insist upon a forfeiture is void.⁴

§ 699-§ 701. *By-laws and Regulations must accord with the Charter or Incorporation Paper.*

§ 699. **In general.** — The next requirement is that the by-laws or regulations shall be not merely consonant with law, but also in the case of companies incorporated under a general law in accordance with the company's incorporation paper,⁵ or in the case of corporations created by royal charter, with the charter.⁶ Thus, a regulation purporting to authorize an extension of the company's business beyond the objects expressed or implied in the incorporation paper is inefficacious.⁷ Of course, a by-law which conflicts with an illegal and void provision of the incorporation paper is not by reason of that conflict rendered invalid.⁸

¹ *Pulford v. Fire Dept.*, 31 Mich. *Free Grammar School*, 14 L. J. Q. B. 458, 466; *Goddard v. Merchants'* 67; *Rex v. Bumstead*, 2 B. & Ad. Exchange, 9 Mo. App. 290 (affirmed 699.
on opinion below in 78 Mo. 609).

See also *supra*, p. 564, n. 1.

² *Infra*, § 1252.

³ *Infra*, § 1216.

⁴ *Morgan v. Independent Order, etc. of Jacob* (Miss.), 44 So. 791.

⁵ *Bergman v. St. Paul, etc. Bldg. Ass'n*, 29 Minn. 275; 13 N. W. 120.

⁶ *Regina ex rel. May v. Darlington*

⁷ *Ashbury Ry., etc. Co. v. Riche*, L. R. 7 H. L. 653, 671 (headnote inadequate).

Cf. *Andrews v. Union Mutual Fire Ins. Co.*, 37 Me. 256.

⁸ *Booz's Appeal*, 109 Pa. St. 592;

1 Atl. 36.

§ 700. **Must relate to Prosecution of Company's Objects or Business.** — Every by-law of a corporation must have for its object the furtherance of the company's business or undertaking. An industrial or business corporation has no right to legislate for the spiritual health or moral welfare of the community at large, or even of its own members.¹ On this ground, a by-law of a canal company prohibiting navigation on its waterway on Sunday has been held void.² Although no one will call in question the principle of this decision, yet the application to that particular case may well be deemed doubtful. Certainly, a mere private industrial company may by its regulations prohibit the transaction of its business on Sunday, not indeed on religious or moral grounds, but merely for the well-being of the corporation.³ If, therefore, the canal case is to be supported, it must be upon the ground that a canal is a public highway, so that the right of a company to regulate navigation thereon will be jealously restricted within the narrowest limits. Of course, a corporation which is formed for the purpose of promoting commercial integrity among the members, such as the mediæval guilds, or for the purpose of encouraging morality or religion among its members, may enact any by-laws reasonably adapted to the attainment of those ends.⁴ In every case, the question is whether the by-law is germane to the purpose for which the company is formed. To attempt to collate all the cases would, therefore, be both profitless and impertinent.

§ 701. **Whether express Power to enact By-laws for one Purpose excludes implied Power to enact By-laws for other Purposes.** — There is an oft-cited dictum of Lord Macclesfield in an early case that a provision in a company's charter conferring power to

¹ *Kolff v. St. Paul Fuel Exchange*, 48 Minn. 215 (headnote inadequate); 50 N. W. 1036.

² *Calder Nav. Co. v. Pilling*, 14 M. & W. 76. A by-law of a charitable society requiring members to receive the sacrament according to the rites of the Roman Catholic Church is void. *People ex rel. Schmitt v. Saint Franciscus Benevolent Society*, 24 How. Pr. (N. Y.) 216 (headnote inadequate).

³ *Granger v. Grubb*, 7 Phila. (Pa.) 350.

⁴ *Warren v. Louisville Leaf, etc. Co.*, 55 S. W. Rep. 912 (Ky.); *People v. Chicago Board of Trade*, 45 Ill. 112; *People ex rel. Thacher v. N. Y. Commercial Ass'n*, 18 Abb. Pr. (N. Y.) 271; *Dickenson v. Chamber of Commerce*, 29 Wisc. 45; 9 Am. Rep. 544; *Wood v. Chamber of Commerce*, 119 Wisc. 367; 96 N. W. 835 (where the offence was committed outside the territorial jurisdiction of the corporation).

enact by-laws for one purpose impliedly prohibits by-laws for any other purpose.¹ But in that case, the power conferred was to make by-laws for the management of the company's business, and the by-law that was held invalid related to an *ultra vires* and illegal enterprise. The case, therefore, decides merely that power to enact by-laws for *intra vires* purposes forbids by implication by-laws for *ultra vires* purposes — a proposition that needs no argument in its support. Probably, the chancellor intended to lay down no other or further proposition of law. It is submitted that a power to enact by-laws for one *intra vires* purpose does not prohibit by-laws for other *intra vires* objects.² Indeed, as we have already shown, the power to enact by-laws is little more than the power to prescribe a regular order or course of action, instead of leaving each particular case to be dealt with separately; and hence the power cannot well be severed from the power of the corporation to act in respect to any subject-matter. At all events, it is submitted that the maxim *expressio unius exclusio alterius* should be very cautiously applied where the effect is to abridge the company's power of making by-laws or rules for its orderly government. The legislature should be required to use express language if it desires to accomplish that object.

§ 702—§ 715. OF THE RULE THAT BY-LAWS MUST BE REASONABLE.

§ 702. In general — As applied to By-laws and English Articles. — From the earliest times, it has been laid down and held that by-laws to be valid must be reasonable. In America this doctrine is constantly enforced by the courts with possibly too great rigor. No instance has been found in which articles of association of an English company that were consistent with law and with the terms of the memorandum have been held invalid distinctly on the mere ground of unreasonableness. Yet it is not

¹ *Child v. Hudson's Bay Co.*, 2 P. Wms. 207, 209. Accord: *Ireland v. Globe Milling Co.*, 19 R. I. 180; *State v. Ferguson*, 33 N. H. 32 Atl. 921; 61 Am. St. Rep. 756; 424, 430-431 (municipal ordinances). 29 L. R. A. 429 (with which compare ² *People's Home Sav. Bank v. Ireland v. Globe Milling Co.*, 21 R. I. Sadler (Cal.), 81 Pac. 1029. 9; 41 Atl. 258; 79 Am. St. Rep. 769;

to be doubted that in a clear case an English court would apply the doctrine to articles of association.¹ Of course, as already more than once stated, the greater formality of English articles of association protects from the imputation of unreasonableness many provisions that in mere unrecorded by-laws would be open to that objection. Moreover, inasmuch as the original articles of a British company are prepared and recorded contemporaneously with the memorandum of association, every subscriber to shares has knowledge, or the opportunity of knowledge, of their terms, and consequently cannot with much grace complain that although legal they are unreasonable and so void. Then, too, the British courts, with a disposition to adhere closely to the phraseology of the particular statute in question without regarding the act as a mere part of the historical development of corporation law, may be unduly influenced by the fact that their statute confers in unlimited terms the power of enacting articles of association.

In a recent case, Lindley, M. R., said, "Wide, however, as the language of s. 50 is" — the section of the Companies Act which confers the power of altering the articles of association — "the power conferred by it must, like all other powers, be exercised subject to those general principles of law and equity which are applicable to all powers conferred on majorities, and enabling them to bind minorities. It must be exercised, not only in the manner required by law, but also *bona fide* for the benefit of the company as a whole, and it must not be exceeded. These conditions are always implied and are seldom, if ever, expressed. But if they are complied with, I can discover no ground for judicially putting any other restrictions on the power conferred by the section than are contained in it."²

However, an article declaring that if any member of the company should commence or threaten any legal proceedings against the company his shares should be liable to forfeiture has been held invalid.³ And an article that is adopted for a fraudulent purpose is void.⁴ So, it has been thought that an article varying

¹ Cf. *Mineral Water Bottle, etc. Soc. v. Booth*, 36 Ch. D. 465 (where a provision in articles of association in unreasonable restraint of trade was held void).

² *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656, 671.

³ *Hope International Financial Soc.*, 4 Ch. D. 327.

⁴ *Clarke & Helden's Case*, 37 L. T. 222.

the liability of the several shareholders on their respective shares without their consent, increasing that of some and diminishing that of others, would be void.¹

§ 703. **By-laws presumptively reasonable.** — It is unnecessary to consider what by-laws are reasonable, but rather to inquire what are unreasonable. Any by-law that is not in conflict with any statute or with the company's charter or incorporation paper, is presumptively valid; and the burden of showing its unreasonableness rests upon the party who challenges its validity.²

§ 704. **Legal Standard of Reasonableness.** — Before considering in detail certain groups or classes of unreasonable and consequently invalid by-laws the legal rule or standard of reasonableness should be clearly understood. "In order to avoid a by-law upon the ground of its being unreasonable because of some inconvenience that may result from it, it should appear to be a probable inconvenience; for one can hardly predicate, of any law, that some possible inconvenience may not result from it."³ Moreover, "the long continuance of a by-law, though it would not legalize it if it were in itself illegal, is fair evidence to show that there is no intrinsic inconvenience in it."⁴ The question whether or not a by-law is unreasonable is, in actions at law, for the court and not the jury.⁵

§ 705-§ 711. BY-LAWS IN RESTRAINT OF TRADE OR ALIENATION.

§ 705. **In general.** — One of the most ancient grounds for declaring a by-law to be unreasonable and void is that it operates in unreasonable restraint of trade or alienation.⁶ The rule in reference to by-laws restraining trade or alienation is the same

¹ *Teasdale's Case*, 9 Ch. 54, 59 350, 351 (headnote inadequate); *Hibernia Fire, etc. Co. v. Commonwealth ex rel. Harrison*, 93 Pa. St. 264; *Master & Company of Frameworke v. Green*, 1 Ld. Raym'd 113, 114 (headnote inadequate).

² *Granger v. Grubb*, 7 Phila. (Pa.) 264; *Master & Company of Frameworke v. Green*, 1 Ld. Raym'd 113, 114 (headnote inadequate). Cf. *State v. Overton*, 24 N. J. Law 435, 440-442; 61 Am. Dec. 671; *Morris, etc. R. R. Co. v. Ayres*, 29 N. J. Law 393; *Compton v. Van Volkenburgh*, 34 N. J. Law 134.

³ *Rex v. Ashwell*, 12 East 22, 28-29 (per Lord Ellenborough, C. J.). ⁴ *Rex v. Ashwell*, 12 East 22, 29 (per Lord Ellenborough, C. J.), 32-33 (per Bayley, J.). ⁵ Cf. *Ipswich Taylors' Case*, 11 Coke 53.

⁶ *Granger v. Grubb*, 7 Phila. (Pa.) Coke 53.

as the rule in respect to contracts having a similar effect. That is to say, a by-law is not void merely because its enforcement will result in restraint of trade; in addition to this, the restraint of trade must be unreasonable. For this reason, Lord Kenyon thought that a by-law of a company of fishermen forbidding any member from carrying on trade on his own account in competition with the company would be valid.¹ But any by-law the effect of which is restraint of trade is *prima facie* void, and therefore cannot be enforced unless the party relying upon it establishes affirmatively the reasonableness of the restraint. For this reason, a by-law of a guild of gunmakers of London prohibiting its members from selling guns to non-members within the city, or from stamping their marks on wares manufactured by non-members, was declared void.² For the same reason, a by-law of a guild of coopers forbidding any member to have more than one apprentice is invalid.³ So a regulation of an association of manufacturers providing that no member should employ a servant who had left the service of another member is void.⁴

§ 706-§ 711. *By-laws restricting Transferability of Shares.*

§ 706. **In general.** — In these latter days, although the attempts of corporations to restrain trade are certainly not less frequent than in former times, yet the object is sought to be accomplished in different ways from those which the cases above cited show to have been employed in former times. The same principles of law, however, apply. The most frequent application of these principles to the by-laws of modern incorporated companies is in cases of attempts to restrict the free transferability of the shares. Many by-laws having such an

¹ *Rex v. Company of Fishermen*, Press, 136 N. Y. 333; 32 N. E. 981; 8 T. R. 352. *Quære* whether this dictum is law with respect to modern incorporated joint-stock companies.

² *Master, etc. of Gunmakers v. Fell*, Willes 384.

³ *Rex v. Wardens of Coopers' Co.*, 7 T. R. 543.

⁴ *Mineral Water Bottle, etc. Soc. v. Booth*, 36 Ch. D. 465.

But cf. *Matthews v. Associated*

object have been relentlessly stricken down. Thus, a by-law restricting the right of shareholders to alienate their shares, by providing that any one desiring to sell shall first notify the company of the price he can obtain, at which price the other shareholders or the company shall have the option of purchasing, has been held void.¹ *A fortiori*, it has been held that a by-law forbidding a transfer of shares without the consent of all the shareholders or of the directors is void;² and the same is true of a by-law limiting the number of shares which any one person may hold.³ The same has been held of a by-law purporting to give the company a lien on its shares for all debts of the holders, and to forbid any transfer until such indebtedness is paid;⁴ although, according to the weight of authority, such a

¹ *Victor G. Bloede Co. v. Bloede*, 84 Md. 129; 34 Atl. 1127; 57 Am. St. Rep. 373; 33 L. R. A. 107; *Ireland v. Globe Milling Co.*, 21 R. I. 9; 41 Atl. 258; 79 Am. St. Rep. 769; *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447; 24 S. W. 129.

But cf. *Pfister v. Gerwig*, 122 Ind. 567; 23 N. E. 1041; *Blue Mt. Forest Ass'n v. Borrowe*, 71 N. H. 69; 51 Atl. 670; *Barrett v. King*, 63 N. E. 934; 181 Mass. 476.

² *In re Klaus*, 67 Wisc. 401; 29 N. W. 582; *Miller v. Farmers' Milling, etc. Co.* (Nebr.), 110 N. W. 995. *Farmers', etc. Bank v. Wasson*, 48 Iowa 336; 30 Am. Rep. 398; *Imperial Starch Co.*, 10 Ont. L. R. 22.

Cf. *Herring v. Ruskin, etc. Ass'n*, 52 S. W. Rep. 327 (Tenn.); *McNulta v. Corn Belt Bank* 164 Ill. 427, 447; 45 N. E. 954; 56 Am. St. Rep. 203; *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90; 19 Am. Dec. 306.

³ *Miller v. Farmers' Milling, etc. Co.* (Nebr.), 110 N. W. 995; *O'Brien v. Cummings*, 13 Mo. App. 197. Cf. *Richardson v. Devine* (Mass.), 79 N. E. 771.

⁴ *Driscoll v. West Bradley, etc. Co.*, 59 N. Y. 96; *Kinnan v. Sullivan County Club*, 26 N. Y. App. Div. 213; 50 N. Y. Supp. 95; *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447; 24 S. W. 129; *Bank of Atchison*

Co. v. Durfee, 118 Mo. 431; 24 S. W. 133; 40 Am. St. Rep. 396; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330; *Rosenback v. Salt Springs Nat. Bank*, 53 Barb. (N. Y.) 495; *New Orleans Nat. Banking Ass'n v. Wiltz*, 10 Fed. 330 (head-note inadequate).

Cf. *Feckheimer v. Nat. Exchange Bank*, 79 Va. 80.

But see *Lockwood v. Mechanics Nat. Bank*, 9 R. I. 308; 11 Am. Rep. 253; *Waln's Assignees v. Bank of N. Am.*, 8 S. & R. (Pa.) 73; 11 Am. Dec. 575 (where the lien was established by usage equivalent to a by-law); *Cunningham v. Ala. Life Ins., etc. Co.*, 4 Ala. 652; *Re Bachman*, 2 Fed. Cas. 310; *Geyer v. Western Ins. Co.*, 3 Pittsburg (Pa.) 41; *Young v. Vough*, 23 N. J. Eq. 325; *Child v. Hudson's Bay Co.*, 2 P. Wms. 207; *McDowell v. Bank of Wilmington*, 1 Harr. (Del.) 27; *Knight v. Old Nat. Bank*, 3 Cliff. 429; *Wetherell v. Thirty-first Street, etc. Ass'n*, 153 Ill. 361; 39 N. E. 143; *Re Bachman*, 2 Cent. L. J. 119.

As to a by-law purporting to give the company a lien where by statute loans on security of the company's own shares are forbidden, see *Evanville Nat. Bank v. Metropolitan Nat. Bank*, 2 Biss. 527; *Buffalo German Ins. Co. v. Third Nat. Bank*, 162

by-law is valid except as against purchasers of shares without notice of the regulation,¹ being effective even as against attaching creditors of the shareholder.² A by-law providing that upon the death of a shareholder his shares shall be purchased by the company has been held valid;³ but according to the principles generally established in the United States it would seem necessarily to follow that such a by-law should be held void,⁴ even apart from the objection that it contemplates an unauthorized reduction of capital.

§ 707. **Effect of Agreement of Shareholder to abide by a By-law restricting his Right of Alienation.** — A shareholder may agree to be bound by by-laws which impose restrictions on his power of alienating his shares and which might apart from such agreement be held null and void. For instance, a person who subscribes for shares, with knowledge of a by-law providing that any shareholder desirous of selling his shares, or the executor of any deceased shareholder, shall sell the shares to the company at a valuation to be placed thereon by the directors and who accepts a share-certificate upon which that by-law is indorsed, is taken to agree to be bound thereby; and consequently, whether or

N. Y. 163; 56 N. E. 521; 48 L. R. A. 107, affirmed in *Third Nat. Bank v. Buffalo German Ins. Co.*, 193 U. S. 581; 24 Sup. Ct. 524 (where the by-law although embodied in the share-certificate was held inoperative more on account of the supposed policy of the law favoring the alienability of shares than on account of the express provision in the National Bank Act prohibiting loans on security of the bank's own shares); *Nicollet Nat. Bank v. City Bank*, 38 Minn. 85; 35 N. W. 577; 8 Am. St. Rep. 643; *Delaware, etc. R. R. Co. v. Oxford Iron Co.*, 38 N. J. Eq. 340; *Bank v. Lanier*, 11 Wall. 369; *Bullard v. Bank*, 18 Wall. 589; *Vansands v. Middlesex County Bank*, 26 Conn. 144; *Knight v. Old Nat. Bank*, 3 Cliff. 429, 437; *Bridges v. Nat. Bank of Troy*, 185 N. Y. 146.

v. *Long Island Bank*, 83 Hun (N. Y.) 92; 31 N. Y. Supp. 406; *Tuttle v. Walton*, 1 Ga. 43; *Young v. Vough*, 23 N. J. Eq. 325; *Pendergast v. Bank of Stockton*, 2 Sawy. 108; *Bank of Culloden v. Bank of Forsyth*, 120 Ga. 575; 48 S. E. 226; 102 Am. St. Rep. 115; *McKain and Canadian Birbeck, etc. Co.*, 7 Ont. L. R. 241 (headnote inadequate).

Cf. *Anglo-Californian Bank v. Granger's Bank*, 63 Cal. 359; *Tete v. Farmers', etc. Bank*, 4 Brewst. (Pa.) 308; *Costello v. Portsmouth Brewing Co.*, 69 N. H. 405; 43 Atl. 640; *McDowell v. Bank of Wilmington*, 1 Har. (Del.) 27; *Just v. State Bank*, 94 N. W. 200; 132 Mich. 600.

² *Farmers', etc. Bank v. Haney*, 87 Iowa 101; 54 N. W. 61. See *infra*, § 956.

³ *Howe Grain & Mercantile Co. v. Jones*, 21 Tex. Civ. App. 198; 51 S. W. 24.

⁴ *Herring v. Ruskin Co-op. Ass'n*, 52 S. W. Rep. 327 (Tenn.).

¹ *Grafflin Co. v. Woodside*, 87 Md. 146; 39 Atl. 413 (semble); *Bronson Electric Co. v. Rheubottom*, 122 Mich. 608; 81 N. W. 563; *Gibbs*

not the by-law would *proprio vigore* be operative, an executor of a deceased shareholder may be compelled by a court of equity to assign his shares to the company at the valuation placed thereon by the directors.¹ Moreover, if a shareholder is bound in this way by a contract or agreement to recognize and abide by restrictions upon his power of alienation sought to be imposed by the by-law, any transferee taking with notice is subject to the same restriction;² though the rule is otherwise where he had no notice thereof.³ Similarly, if a shareholder with knowledge of a by-law purporting to give the company a lien on its shares for debts due from the holders borrows money from the company, he will be deemed to pledge his shares to secure the debt whether the by-law be valid or not; and any transferee from the debtor would likewise be bound by the lien unless he be a *bona fide* purchaser for value.⁴

§ 708. **Effect of accepting Share-Certificate referring to the By-law.**—According to some authorities, the mere fact that a by-law purporting to restrict transfers is indorsed on a share-certificate gives it no additional validity;⁵ but according to other cases, the acceptance of such a certificate in itself amounts to a

¹ *New England Trust Co. v. Abbott*, 162 Mass. 148; 38 N. E. 432; 27 L. R. A. 271. The opinion of the court, which of course assumes that the company has power to acquire its own shares, is characterized by a breadth of view to which few of our courts have attained.

Cf. *Blue Mt. Forrest Ass'n v. Borrowe*, 71 N. H. 69; 51 Atl. 670; *Boswell v. Buhl*, 213 Pa. 450; 63 Atl. 56 (upholding an express contract between shareholders whereby any shareholder desiring to sell his shares agreed to offer them to the other shareholders at a price to be determined by a majority of the stock); *Lindsay's Estate*, 210 Pa. 224; 59 Atl. 1074 (similar point as last case); *Fitzsimmons v. Lindsay*, 205 Pa. 79; 54 Atl. 488 (similar point); *Boggs v. Boggs & Buhl* (Pa.), 66 Atl. 105 (specifically enforcing an express contract whereby the majority of the shareholders upon deciding a fellow member to

be an "undesirable associate" should have the right to take his shares at their cash value); *Williams v. Montgomery*, 148 N. Y. 519; 43 N. E. 57 (enforcing a contract between shareholders not to sell their shares for six months).

² *Bank of Atchison Co. v. Durfee*, 118 Mo. 431, 445-447; 24 S. W. 133; 40 Am. St. Rep. 396; *Jennings v. Bank of California*, 79 Cal. 323; 21 Pac. 852; 12 Am. St. Rep. 145; 5 L. R. A. 233.

³ *Ireland v. Globe Milling Co.*, 21 R. I. 9; 41 Atl. 258; 79 Am. St. Rep. 769.

⁴ *Grafflin Co. v. Woodside*, 87 Md. 146; 39 Atl. 413; *Jennings v. Bank of California*, 79 Cal. 323; 21 Pac. 852; 12 Am. St. Rep. 145; 5 L. R. A. 233.

⁵ *Herring v. Ruskin, etc. Ass'n*, 52 S. W. Rep. 327 (Tenn.); *Third Nat. Bank v. Buffalo German Ins. Co.*, 193 U. S. 581; 24 Sup. Ct. 524.

valid contract on the part of the holder to be bound by the restriction.¹ Necessarily such indorsement gives notice of the restriction to every transferee of the certificate,² and we have seen above that such notice may be material. Indeed, a mere reference in a share-certificate to articles of association subject to which the shares are held but the terms of which are not stated has been held sufficient notice to put a purchaser upon inquiry.³ If by-laws which purport to give the company a lien on its shares for debts of the holder provide that notice of the lien shall be endorsed on the share-certificate, a failure to insert such a provision in a certificate amounts to a waiver of the lien on the shares represented thereby, even if the by-law attempting to create the lien be valid.⁴

§ 709. **Observations on unfortunate Condition of American Law in Respect to these Matters.** — Decisions striking down as invalid by-laws which qualify somewhat the otherwise unrestricted right of a shareholder to alienate his shares present a most forcible illustration of the unsatisfactory character of the informal American by-laws. In view of the informal nature of by-laws, no different results, except in some cases, could have been reached by the courts without injustice.⁵ But, certainly, the law is in an

¹ *Stafford v. Produce Exchange Banking Co.*, 61 Oh. St. 160; 55 N. E. 162; 76 Am. St. Rep. 371; *Jennings v. Bank of California*, 79 Cal. 323; 21 Pac. 852; 12 Am. St. Rep. 145; 5 L. R. A. 233; *Morrison-Wentworth Bank v. Kerdolff*, 75 Mo. App. 297.

Cf. *Vansands v. Middlesex County Bank*, 26 Conn. 144; *Reynolds v. Bank of Mt. Vernon*, 6 N. Y. App. Div. 62; 39 N. Y. Supp. 623 (affirmed short in 158 N. Y. 740; 53 N. E. 1131).

² *State Savings Ass'n v. Nixon-Jones Printing Co.*, 25 Mo. App. 642; *Buffalo German Ins. Co. v. Third Nat. Bank*, 19 N. Y. Misc. 564; 43 N. Y. Supp. 550; *Bank of Culloden v. Bank of Forsyth*, 120 Ga. 575; 48 S. E. 226; 102 Am. St. Rep. 115.

³ *Gibbs v. Long Island Bank*, 83 Hun (N. Y.) 92; 31 N. Y. Supp. 406.

Cf. *Des Moines Nat. Bank v.*

Warren County Bank, 97 Iowa 204; 66 N. W. 154; *McKain and Canadian Birbeck, etc. Co.*, 7 Ont. L. R. 241 (where a statement in the certificate that the shares were held subject to the "articles" was held not to give notice of a by-law giving the company a lien).

⁴ *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330; *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 460-461; 24 S. W. 129.

⁵ Cf. *McKain and Canadian Birbeck, etc. Co.*, 7 Ont. L. R. 241 (distinguishing between unrecorded by-laws and recorded "articles" of English companies). As to the distinction in respect to this matter between provisions contained in the recorded constitution of the company and similar provisions contained in mere by-laws, see *Mohawk Nat. Bank v. Schenectady Bank*, 78

unfortunate state if the organizers of a corporation cannot restrict the right of members to transfer their shares, — cannot create a “close corporation.” In England, the validity of articles of association having that effect has been uniformly assumed. Indeed, a whole class of English companies — so-called “private companies” — are formed on this principle. This elasticity of the British law permits of the formation of family corporations and other companies whose shares are not intended for public subscription and which are in reality merely private partnerships authorized by law to enjoy the privilege of doing business under the corporate form. Moreover, in England, an article of association requiring certain shareholders to sell their shares to other members of the company upon demand at not more than their par value is valid;¹ and a similar article has been recently sustained in Ireland.² Although the law ought not, perhaps, to permit a corporation by altering its by-laws or regulations to take away a previously vested freedom of alienating the shares, upon the faith of which the existing shareholders may have acquired their shares — for a by-law having such a retroactive effect may well be held unreasonable — yet surely no harm could result from permitting the organizers of a corporation to insert in the original constitution of the company provisions determining under what restrictions the shares shall be transferable.

§ 710. **Rule against Perpetuities not applicable to By-laws or Regulations restricting Transfers of Shares.** — Regulations restricting the transferability of shares, although perhaps bad as creating an unreasonable restraint of trade, are not obnoxious to the rule against perpetuities. Thus, a provision that at any time during the continuance of the company any shareholder who should not be a “manager or assistant” might be compelled by the company to transfer his shares to a “manager or assistant” for not more than their nominal value as ascertained by a process of calculation does not create a perpetuity, although the right to call for a transfer might be exercised at any indefinite time, however distant, in the future.³ A share in the capital of a company cannot

Hun (N. Y.) 90, 91; 28 N. Y. Supp. 1100; *Bank of Attica v. Manufacturers', etc. Bank*, 20 N. Y. 501.

Cf. *Blue Mt. Forrest Ass'n v. Borowe*, 71 N. H. 69; 51 Atl. 670. See also *supra*, § 122.

¹ *Borland's Trustee v. Steel Brothers & Co.* (1901), 1 Ch. 279.

² *Attorney-General v. Jameson* (1904), 2 Ir. 644.

³ *Borland's Trustee v. Steel Brothers & Co.* (1901), 1 Ch. 279; *Attorney-*

§ 713. **By-laws attempting to bind Minority to Fraudulent or Ultra Vires Acts of Majority.**—A by-law providing that any contract approved by a majority of the shareholders at a general meeting shall bind the company and all the shareholders as though approved by each and all of them cannot be invoked to prevent a minority shareholder from attacking an *ultra vires* or fraudulent contract authorized by the majority of the shareholders.¹ So, a by-law cannot prevent a shareholder from objecting to fraudulent action on the part of the officers or majority shareholders.²

§ 714. **Retroactive By-laws.**—No rigid rule of law prohibits retroactive by-laws or by-laws impairing vested rights.³ Thus, it seems that a by-law may give to a corporation a lien on its shares for debts that are due from shareholders at the time of its adoption.⁴ Nevertheless, in the United States a retrospective by-law, or by-law impairing vested rights, will, to say the least, be looked upon with suspicion;⁵ and every by-law the phraseology of which admits of any doubt will be construed as prospective merely.⁶ Certainly, retrospective by-laws would be in many cases unjust, and therefore unreasonable and void.⁷ Thus, a by-law purporting to give the company a lien on its shares for debts owing by the holders cannot affect the rights of a transferee of shares claiming under a transfer which before the enactment of the by-law had been executed but not entered

Fire Ins. Co., 6 Gray (Mass.) 596; *Soc.*, 82 Cal. 557, 560–561; 22 Pac. 2 May on Insurance, 4th ed., 1125.

§ 478.

But cf. *Mutual Accident, etc. Ass'n v. Kayser* (Pa.), 14 Wkly. Notes Cas. 86 (holding that the by-law is inoperative unless embodied in the policy).

¹ *Hodge v. United States Steel Corp.*, 64 N. J. Eq. 807, 813–818; 54 Atl. 1; 60 L. R. A. 742 (semble).

² *Triesler v. Wilson*, 89 Md. 169; 42 Atl. 926.

³ Cf. *Pepe v. City, etc. Bldg. Soc.* (1893), 2 Ch. 311; *Smith v. Galloway* (1898), 1 Q. B. 71, 77 (headnote inadequate); *Modern Woodmen v. Wieland*, 109 Ill. App. 340.

But see *Stohr v. Musical Fund*

⁴ Cf. *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656. But see *Steamship Dock Co. v. Heron's Adm'x*, 52 Pa. St. 280.

⁵ Cf. *Pulford v. Fire Dept.*, 31 Mich. 458 (“*Ex post facto* laws are no more lawful for corporations than for states”).

⁶ *Brotherhood of Railroad Trainmen v. Newton*, 79 Ill. App. 500. See *infra*, § 731.

⁷ *Lloyd v. Supreme Lodge*, 98 Fed. 66; 38 C. C. A. 654; *Graftstrom v. Frost Council*, 19 N. Y. Misc. 180; 43 N. Y. Supp. 266.

See also *infra*, § 722.

on the company's books.¹ So a by-law which attempts to annul all proxies executed before a certain date cannot be enforced at the same meeting at which it was adopted, so as to have the effect of disfranchising the members who were represented only by such proxies.²

§ 715. **By-laws must be General and Uniform.** — By-laws must not be confined to special cases; they must be general.³ Indeed, we have seen that generality is one of the characteristic features of by-laws, distinguishing them from mere resolutions.⁴ Inasmuch as all by-laws must be general, no validity is imparted to an invalid by-law by a resolution of the corporation which attempts to exempt from its operation the only objector.⁵ On the other hand, a by-law which is general in its terms is not rendered invalid because a special case formed the occasion or motive of its adoption. Thus, in England, an alteration of the articles of association so as to give the company a lien on fully-paid shares for debts due to the company by the holders is not void although at the time only one shareholder is a debtor to the company, and although the regulation is adopted for the purpose of meeting his case.⁶

So also by-laws must be uniform, and must not discriminate arbitrarily against or in favor of certain shareholders.⁷

§ 716-§ 719. *Sanction of By-laws — Fines, Forfeitures, and other Penalties.*

§ 716. **In general.** — Unless by-laws are to be mere *brutum fulmen*, there must be some sanction attached — the company must have some means of punishing infractions of its regulations. Now, all the shareholders of a company by their contract of membership impliedly agree to abide by all lawful by-laws that

¹ *People ex rel. Bosqui v. Crockett*, inadequate); *Isbester v. Murphy* 9 Cal. 112. *Mfg. Co.*, 95 Ill. App. 105 (by-law imposing a forfeiture).

Cf. *Steamship Dock Co. v. Heron's Adm'r*, 52 Pa. St. 280 (headnote inadequate). ⁴ *Supra*, § 687.

² *Walker v. Johnson*, 17 App. *Men's, etc. Society*, 41 Mich. 67.

(D. C.) 144, 165-166. ⁶ *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656.

³ *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413; 15 Pac. 659; ⁷ *North-West Electric Co. v. Walsh*, 29 Can. Sup. Ct. 33, 49. 3 Am. Rep. 169; *People v. Throop*, 12 Wend. (N. Y.) 183, 186 (headnote

the corporation may adopt, and therefore it would seem clear that upon shareholders at least the company may visit penalties for the violation of its regulations.¹ Thus, the by-laws of mediæval incorporated guilds often imposed fines and penalties on members who were guilty of dishonorable or unworkmanlike practices. Upon the same principle, modern business corporations may require their members to pay promptly all calls and lawful assessments upon their shares, and provide for a for-

¹ *Graham v. House-building, etc. Ass'n*, 52 S. W. Rep. 1011 (Tenn.); *Matthews v. Associated Press*, 136 N. Y. 333; 32 N. E. 981; 32 Am. St. Rep. 741; *Jackson v. South Omaha Live Stock Exchange*, 49 Nebr. 687; 68 N. W. 1051.

Cf. *Kirk v. Nowill*, 1 T. R. 118. See also *infra*, § 809.

As to the necessity for notice and an opportunity to contest the imposition of a fine or other penalty, see *State ex rel. Cuppel v. Milwaukee Chamber of Commerce*, 47 Wisc. 670; 3 N. W. 760; *People ex rel. Schmitt v. Saint Franciscus Benevolent Soc.*, 24 How. Pr. (N. Y.) 216; *Gray v. Christian Soc.*, 137 Mass. 329; 50 Am. Rep. 310; *Rex v. Company of Fishermen*, 8 T. R. 352, 356; *Wachtel v. Noah Widows, etc. Society*, 84 N. Y. 28; 38 Am. Rep. 478; *People ex rel. Doyle v. N. Y. Benevolent Soc.*, 3 Hun (N. Y.) 361; *Erd v. Bavarian, etc. Ass'n*, 67 Mich. 233; 34 N. W. 555; *Lysaght v. St. Louis Operative, etc. Ass'n*, 55 Mo. App. 538; *Colton Jammers, etc. Ass'n v. Taylor*, 23 Tex. Civ. App. 367; 56 S. W. 553; *Purdy v. Bankers' Life Ass'n*, 74 S. W. 486; 101 Mo. App. 91. Cf. *Hussey v. Gallagher*, 61 Ga. 86; *Green v. Board of Trade*, 174 Ill. 585; 51 N. E. 599; 49 L. R. A. 365; *People ex rel. Devorell v. Musical, etc. Union*, 118 N. Y. 101; 23 N. E. 129; *Byrne v. Supreme Circle* (N. J.), 65 Atl. 839.

But see *Berkhout v. Royal Arcanum*, 62 N. J. Law 103; 43 Atl. 1; *People ex rel. Dodson v. Board of Trade*, 79 N. E. 611; 224 Ill. 370

(upholding a self-executing regulation for forfeiture of membership in a board of trade).

As to the necessity of spreading on the records of the corporation the exact charge for which the penalty is sought to be imposed, see *Roehler v. Mechanics' Aid Society*, 22 Mich. 86.

As to the necessity of affirmative proof of commission of the offence, see *Rex v. Company of Fishermen*, 8 T. R. 352.

As to other matters concerning the conduct of the "trial," see *People ex rel. Thacher v. N. Y. Commercial Ass'n*, 18 Abb. Pr. (N. Y.) 271; *People ex rel. Meads v. Alpha Lodge*, 13 N. Y. Misc. 677; 35 N. Y. Supp. 214; *Green v. Board of Trade*, 174 Ill. 585; 51 N. E. 599; 49 L. R. A. 365; *Modern Woodmen v. Deters*, 65 Ill. App. 368; *Wood v. Chamber of Commerce*, 119 Wisc. 367; 96 N. W. 835 (holding that the person who preferred the charge is not disqualified from acting as one of the triers, etc.); *Derry v. Great Hive, etc. of Maccabees*, 98 N. W. 23; 135 Mich. 494; *Barker v. Great Hive, etc. of Maccabees*, 98 N. W. 24; 135 Mich. 499; *Bryant v. D. C. Dental Soc.*, 26 App. D. C. 461 (evidence if heard before committee need not be submitted to society at large when report is adopted).

Quære whether a court of equity will lend its aid to the enforcement of a fine imposed for breach of a by-law; *Shannon v. Howard Mut. Bldg. Ass'n*, 36 Md. 383, 393-394. See also *infra*, § 719.

feiture of the shares in case of default.¹ A by-law providing for a penalty only in case the recalcitrant member refuses to arbitrate is not necessarily bad.² Instances of the imposition of penalties for breach of by-laws most frequently occur in social or semi-social corporations; but the same principle would seem to apply to ordinary business corporations. The only difference is that in the case of business corporations just cause for the imposition of penalties arises but seldom. Undoubtedly, however, the belief is prevalent among lawyers that modern business corporations have no power to enact by-laws imposing fines or penalties except in so far as the power may be expressly conferred by statute. Perhaps this idea may be due in part at least to a notion that pecuniary fines imposed by mere by-laws would be obnoxious to the principles of limited liability.

§ 717. **Void and unenforceable Penalties.** — On the other hand, while the power in some cases to enforce by-laws by penalties inflicted upon delinquents is submitted to be on principle incontestable; yet penalties and forfeitures are never favored in law. Thus, a by-law of a society of cutlers purporting to authorize its officers to seize and confiscate any unworkmanly wares found in the shops of any of its members was held to be void.³ The power of the company to enforce its regulations by fines or amercements was undoubted, and was indeed expressly conferred; but this by-law went further, and by vesting a dangerous discretion in the officers, especially in respect to so delicate a matter as a forfeiture, transcended the limits of reason, and was therefore void. So, it is held that a by-law imposing a penalty on a penalty — that is, a penalty for non-payment of a penalty — is void.⁴ For this reason, where a by-law prohibits members from becoming members of a rival corporation and imposes a pecuniary fine on those who disregard the regulation, a provision that delinquents shall forfeit all rights to participate in the com-

¹ *Sparks v. Company, etc. of the Liverpool Waterworks*, 13 Ves. 428. See infra, § 809. Cf. *Cahill v. Kalamazoo Mut. Ins. Co.*, 2 Doug. (Mich.) 124, 137-139; 43 Am. Dec. 457.

² *Haebler v. N. Y. Produce Exchange*, 149 N. Y. 414; 44 N. E. 87. But, see *State ex rel. Kennedy v. Union Merchants' Exchange*, 2 Mo. App. 96.

³ *Kirk v. Nowill*, 1 T. R. 118.

⁴ Cf. *Hagerman v. Ohio Bldg., etc. Ass'n*, 25 Oh. St. 186, 202-203; *Lynn v. Freemansburg, etc. Ass'n*, 117 Pa. St. 1 (headnote inadequate); 11 Atl. 537; 2 Am. St. Rep. 639; *Albers v. Merchants' Exchange*, 39 Mo. App. 583.

pany's profits until the fine is paid is void, irrespective of the question whether it be permissible to prohibit members from joining rival companies.¹ So a by-law of a mutual insurance company which increases the penalties to which members are subjected for non-payment of assessments is not binding upon a member who has never received notice of the change in the regulations.² Moreover, a by-law which imposes a penalty out of all proportion to the offence will be held unreasonable and therefore void³ even though the right to impose fines be expressly conferred by statute.⁴ The only penalties that can as a rule be imposed are either pecuniary fines or forfeiture of membership; for a corporation has no power to imprison a member for breach of a by-law.⁵ A by-law which purports to leave the amount of the fine entirely to the discretion of the directors is void;⁶ but if the by-law fix a reasonable maximum penalty, there is no objection to a provision that the precise amount of the penalty shall be discretionary with the company in each case.⁷

§ 718. **Penalties attempted to be imposed for doing what the Member has a legal Right to do.** — A by-law which attempts to fine or otherwise punish a member for doing that which he has a legal right to do — for example, for refusing to defray the expense of a dinner for the members of the company — is plainly void.⁸ This principle is sufficient to sustain a decision that a by-law of a corporation owning a creamery which provided for the forfeiture of shares owned by any member who should refuse to furnish milk to the company is void.⁹

§ 719. **Remedies for Enforcement of Fines — Defences.** — A fine imposed under a valid by-law may be recovered from a delinquent shareholder in an action of debt or assumpsit. The

¹ *Adley v. Reeves*, 2 M. & S. 53.

⁶ *Albers v. Merchants' Exchange*,

² *Northwestern Life Ins. Co. v.* 39 Mo. App. 583.

Erlenkoetter, 90 Ill. App. 99.

⁷ *Piper v. Chappell*, 14 M. & W. 624.

³ *Graham v. House-building, etc.*

⁸ *Carter v. Sanderson*, 5 Bing. 79;

Ass'n, 52 S. W. Rep. 1011, 1013-1014

Master & Company of Frame-

(Tenn.); *Lynn v. Freemansburg,*

workers v. Green, 1 Ld. Raym. 113;

etc. Ass'n, 117 Pa. St. 1; 11 Atl. 537;

and cases cited *infra*, § 809.

2 Am. St. Rep. 639.

⁹ *March v. Fairmount Creamery*

⁴ *Vierling v. Mechanics', etc.*

Ass'n, 32 Pa. Super. Ct. 517. The

Ass'n, 179 Ill. 524; 53 N. E. 979.

court rested its decision on the

⁵ *Carter v. Sanderson*, 5 Bing. 79,

ground that a by-law of a joint-

89 (per Best, C. J.); *McGannon v.*

stock corporation cannot impose

Central Bldg. Ass'n, 19 W. Va. 726

a forfeiture without statutory

(semble).

authority.

declaration, however, must set out the by-law that the court may judge of its sufficiency,¹ and hence recovery cannot be had under the common counts.² It seems that a suit in equity cannot be maintained to enjoin the imposition of a pecuniary fine under an invalid by-law; for the remedy at law by resisting an attempt to collect the fine is ample.³

§ 720-§ 727. *Amendment and Repeal of By-laws.*

§ 720. **In general.** — In general, by-laws may be amended or repealed at the pleasure of the authority by whom they were enacted.⁴

§ 721. **Amendment or Repeal affecting the Company's Constitution.** — In England, the Companies Act confers upon every company in unrestricted terms the power to amend its articles of association. Nevertheless, an early case held that the power of alteration did not extend to a change in the company's *constitution*.⁵ Obviously, however, this attempted distinction would lead to all manner of confusion; for how is it possible to distinguish between by-laws which do and by-laws which do not form part of the company's "constitution"? Accordingly, the attempted distinction has been overruled by a comparatively recent case, where the English Court of Appeal held that articles of association which did not originally provide for preferred shares might be altered so as to permit an increase of capital by

¹ *Master, etc. of Feltmakers*, 1 B. *Equitable Bldg., etc. Soc.*, 186 Ill. & P. 98. 183; 57 N. E. 873. Cf. *Van Atten*

² *Ottawa Union Bldg. Soc. v. Scott*, 24 Up. Can. Q. B. 341. *v. Modern Brotherhood* (Iowa), 108 N. W. 313. See also *supra*, § 120.

³ *Thomas v. Musical, etc. Union*, 121 N. Y. 45; 24 N. E. 24; 8 L. R. A. 175. Cf. *supra*, § 716 n. As to the necessity for giving notice of an intention to move an amendment to the by-laws, see

⁴ *Rex v. Ashwell*, 12 East 22; *Bagley v. Reno Oil Co.*, 201 Pa. 78; 50 Atl. 760; 56 L. R. A. 184.

Scanlan v. Snow, 2 App. D. C. 137, 154-155; *Dornes v. Supreme Lodge*, 75 Miss. 466; 23 So. 191; *Supreme Lodge v. Knight*, 117 Ind. 489; 20 N. E. 479; 3 L. R. A. 409. Of course, when so-called "by-laws" are made a part of the incorporation paper, they are, like any other part of that instrument, unamendable. *Fritze v.* 2 Dr. & Sm. 521.

⁵ *Hutton v. Scarborough Hotel Co.*, 2 Dr. & Sm. 521.

issue of shares carrying preferential rights.¹ Whether or not this decision is in all respects beyond criticism, it is clearly correct in so far as it holds that by-laws or their English counterpart, articles of association, are not unalterable merely because they pertain to the company's "constitution." If in any particular case they are not amendable, the unalterability must rest on some other ground.

§ 722. **Amendments affecting Vested or Contractual Rights acquired under By-law.** — For example, rights may vest under a by-law which would render its amendment or repeal unjust and unreasonable, and therefore void.² Thus, where the rights of shareholders in respect to dividends and the like have been fixed by a by-law, a subsequent alteration in those rights is not permissible, although the power of altering by-laws be conferred by statute in unlimited terms.³ So, too, a corporation may incorporate certain provisions of the by-laws into a contract so that the same cannot be repealed so far as their application to that particular contract is concerned.⁴

¹ *Andrews v. Gas Meter Co.* (1897), 1 Ch. 361. Cf. *Stephenson v. Vokes*, 27 Ont. (Can.) 691.

² See Boisot on By-Laws, 2d ed., § 120, § 124; *Wiedynska v. Pulaski Polish Benev. Soc.*, 110 N. Y. App. Div. 732; 97 N. Y. Supp. 413.

³ *Kent v. Quicksilver Mining Co.*, 78 N. Y. 159; *Gellerman v. Atlas Foundry, etc. Co.* (Wash.), 87 Pac. 1059.

⁴ *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656, 673-674, 676, 679; *British Equitable Ins. Co. v. Bailey* (1906), A. C. 35, 36 (semble); *Punt v. Symons & Co.* (1903), 2 Ch. 506, 511; *Morrison v. Wisconsin Odd Fellows, etc. Ins. Co.*, 59 Wisc. 162; 18 N. W. 13; *Nelson v. Gibson*, 92 Ill. App. 595; *Wist v. Grand Lodge*, 22 Oreg. 271; 29 Pac. 610; 29 Am. St. Rep. 603; *Smith v. Supreme Lodge*, 83 Mo. App. 512; *Northwestern, etc. Ass'n v. Wanner*, 24 Ill. App. 358; *Covenant Mut. Life Ass'n v. Kentner*, 188 Ill. 431; 58 N. E. 966; *Ins. Co. v. Connor*, 17 Pa. St. 136; *Becker v. Farmers' Mut. Ins. Co.*, 48 Mich. 610; 12 N. W. 874; *Pokrefky v. Firemen's Fund Ass'n*, 121 Mich. 456; 80 N. W. 240; *Holyoke, etc. Ass'n v. Lewis*, 1 Colo. App. 127; 27 Pac. 872; *Savage v. People's Bldg., etc. Ass'n*, 45 W. Va. 275; 31 S. E. 991; *Becker v. Berlin, etc. Soc.*, 144 Pa. St. 232; 22 Atl. 699; 27 Am. St. Rep. 624; *Court of Honor v. Hutchens* (Ind.), 82 N. E. 89; *Rollins v. Co-operative Bldg. Bank*, 98 N. Y. App. Div. 606; 90 N. Y. Supp. 631; *Field v. Eastern, etc. Loan Ass'n*, 90 N. W. 717; 117 Iowa 185.

Quære whether the company could be enjoined from adopting a by-law or regulation inconsistent with the contract or whether the company should not be permitted to make such changes in its regulations as it sees fit, leaving the stipulations of the contract capable of enforcement notwithstanding the alteration. Cf. *Punt v. Symons & Co.* (1903), 2 Ch. 506.

§ 723. **General power to alter By-laws cannot be surrendered by Contract or Provision in the Regulations themselves.** — On the other hand, a company cannot contract itself out of its general power to alter its regulations.¹ Moreover, a provision in by-laws, or English “articles of association,” that they shall be unamendable is ineffective.² So, where the by-laws provide that they shall be amended only by a two-thirds vote, they may nevertheless be amended by a mere majority.³ Upon this principle, where a by-law provides no proposition shall become a “statute” of the corporation until it shall have passed three successive readings, the final vote being taken by yeas and nays, etc., an amendment to the by-laws will nevertheless be valid upon adoption by the corporation, although in its passage the provision above referred to may not have been observed.⁴ So, where the power of adopting and amending by-laws is vested in the directors, a provision in the by-laws that no amendment thereto shall become operative until approved by the shareholders is void.⁵ *A fortiori*, a by-law purporting to intrust to the directors the exclusive power of amending the by-laws is void.⁶

§ 724. **Contracts with Company to be construed if possible so as not to interfere with Power of altering By-laws.** — Moreover, a contract will not be held to render any of the company’s regulations unamendable, even as regards rights vested under that contract, unless such is demonstrated to have been the clear

¹ *Punt v. Symons & Co.* (1903), 2 Ch. 506, 511.

² *Walker v. London Tramways Co.*, 12 Ch. D. 705.

³ *Richardson v. Union Congregational Society*, 58 N. H. 187; *Katz v. H. & H. Mfg. Co.*, 95 N. Y. Supp. 663; 109 N. Y. App. Div. 49, affirmed in 183 N. Y. 578.

But see *Baltimore, etc. R. R. Co. v. Baltimore, etc. Relief Ass’n*, 77 Md. 566, 570–572 (headnote inadequate); 26 Atl. 1045; *Loewenthal v. Rubber Reclaiming Co.*, 52 N. J. Eq. 440, 445 (headnote inadequate); 28 Atl. 454; *Van Atten v. Modern Brotherhood* (Iowa), 108 N. W. 313. In *Scanlon v. Snow*, 2 App. D. C. 137, the view contrary to that stated in the text was assumed by the court

to be correct. Cf. *Connell v. Stalker*, 21 N. Y. Misc. 609, 612; 48 N. Y. Supp. 77; *Flaherty v. Benevolent Society*, 99 Me. 253; 59 Atl. 58.

⁴ *Supreme Lodge v. Kutscher*, 179 Ill. 340, 345–346; 53 N. E. 620; 70 Am. St. Rep. 115; *Supreme Lodge v. Trebbe*, 179 Ill. 348; 53 N. E. 730; 70 Am. St. Rep. 120.

But see *Mutual Aid, etc. Soc. v. Monti*, 59 N. J. Law 341; 36 Atl. 666.

Cf. *Dornes v. Supreme Lodge*, 75 Miss. 466; 23 So. 191.

⁵ *Manufacturers’ Exhibition Bldg. Co. v. Landay*, 76 N. E. 146 (headnote misleading); 219 Ill. 168.

⁶ *Alters v. Journeyman, etc. Ass’n*, 19 Pa. Super. Ct. 272.

intention, particularly where the by-laws or regulations themselves provide for alteration.¹ Said Lindley, M.R., in a famous case: "A company cannot break its contracts by altering its articles, but, when dealing with contracts referring to revocable articles, and especially with contracts between a member of the company and the company respecting his shares, care must be taken not to assume that the contract involves as one of its terms an article which is not to be altered."² Upon this principle the court decided that a vendor who transfers property to a company in consideration of fully paid shares has no contract binding the company not to alter its articles so as to acquire a lien on its paid-up shares for debts owing by their holders.³ So, a provision in English articles of association that a certain proportion of the capital shall not be called in except in the case of a winding-up, although subscribers have taken shares on the faith thereof, does not prevent the company from altering its articles so as to permit a call presently.⁴ The principles respecting the limits of the power of a corporation to alter its by-laws are most frequently applied in the case of mutual insurance companies, and the like, where the members occupy a dual relation as members and as creditors; and the courts will be much more inclined to hold void an alteration in the by-laws

¹ *East Tennessee, etc. R. R. Co. v. Gammon*, 5 Sneed (Tenn.) 567, 571-572; *Poultney v. Bachman*, 31 Hun (N. Y.) 49; *Stohr v. Musical Fund Soc.*, 82 Cal. 557; 22 Pac. 1125; *Reynolds v. Supreme Council* (Mass.), 78 N. E. 129; 192 Mass. 150; 7 L. R. A. 1154; *Gaines v. Supreme Council*, 140 Fed. 978; *Mock v. Supreme Council*, 106 N. Y. Supp. 155.

Cf. *Crittenden v. Southern Home Bldg., etc. Ass'n*, 111 Ga. 266; 36 S. E. 643; *Supreme Lodge v. Knight*, 117 Ind. 489; 20 N. E. 479; 3 L. R. A. 409; *Pain v. Société St. Jean Baptiste*, 172 Mass. 319; 52 N. E. 502; 70 Am. St. Rep. 287; *Supreme Commandery v. Ainsworth*, 71 Ala. 436; *Engelhardt v. Fifth Ward Loan Ass'n*, 148 N. Y. 281; 42 N. E. 710; 35 L. R. A. 289; *Fugure v. Mutual Society*, 46 Vt.

362; *Pepe v. City, etc. Bldg. Soc.* (1893), 2 Ch. 311; *Wright v. Incorporated Synod*, 11 Can. Sup. Ct. 95. See Boisot on By-Laws, 2d ed., § 119, § 122.

In some cases such as *Bornstein v. District Grand Lodge* (Cal.), 84 Pac. 271, a provision in a contract to abide by such by-laws as might be adopted was held to refer only to such by-laws as might be reasonable in view of the rights which had already vested under the contract. Cf. *Strang v. Camden Lodge* (N. J.), 64 Atl. 93; *Lange v. Royal Highlanders* (Nebr.), 106 N. W. 224.

² *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656, 673.

³ *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656.

⁴ *Malleson v. National Ins. Corp.* (1894), 1 Ch. 200.

which alters their rights as creditors than if their rights as members were alone affected.¹ The decisions are far from harmonious upon the question what alterations of by-laws will be deemed to violate the contract between the corporation and persons who became members prior to the change; but as the question has usually arisen in respect to other than ordinary joint-stock corporations, a detailed consideration of the cases would be inappropriate. As intimated above, the English courts probably go further than the American courts in permitting amendments of by-laws or articles of association to disturb vested rights or expectations.

§ 725. **Whether Provision in the By-laws may authorize Amendment without complying with statutory Requisites.** — Where a statute provides that by-laws shall not be amended except by a two-thirds vote, or the like, the by-laws cannot be legally altered in any other way. Hence, a clause in the articles of association or by-laws of a Canadian company purporting to authorize an amendment at any meeting of the company by mere majority vote is invalid where the act of parliament requires a “special resolution”² in order to alter the articles.³

§ 726. **Repeals by Implication.** — Where a new code of by-laws, apparently complete, is adopted as “the by-laws” of the company, all the old by-laws are to be deemed repealed by implication.⁴

¹ *Knights Templars', etc. Co. v. Jarman*, 104 Fed. 638, 644; 44 C. C. A. 93.

Cf. *Bornstein v. District Grand Lodge* (Cal.), 84 Pac. 271.

In *Baily v. British Equitable Assurance Co.* (1904), 1 Ch. 374, 385 (reversed on a different point in *British Equitable Assurance Co. v. Baily* (1906), A. C. 35); Cozens-Hardy, L. J., speaking for the court, said: “The rights of a shareholder in respect of his shares, except so far as they may be protected by the memorandum of association, are by statute made liable to be altered by special resolution. . . . But the case of a contract between an outsider and the company is entirely different, and even a shareholder must be re-

garded as an outsider in so far as he contracts with the company otherwise than in respect of his shares. It would be dangerous to hold that in a contract of loan or a contract of service or a contract of insurance validly entered into by a company there is any greater power of variation of the rights and liabilities of the parties than would exist if, instead of the company, the contracting party had been an individual.”

But see *Punt v. Symons & Co.* (1903), 2 Ch. 506, 514-515.

² As to the meaning of this term, see *infra*, § 1241.

³ *Twigg v. Thunder Hill Mining Co.*, 3 Brit. Columb. 101.

⁴ *Murphy v. Pacific Bank*, 130 Cal. 542, 549-550; 62 Pac. 1059.

§ 727. **Repeals by Desuetude.** — We have seen above that custom may have the force of a by-law;¹ and a necessary corollary of that proposition is that a similar custom may also repeal a by-law. Consequently, long-continued disregard of the provisions of a by-law may be equivalent to an express repeal. Even a by-law which has been formally adopted may lapse or be repealed by desuetude.²

§ 728. **Disregard of By-laws without formal Repeal.** — By-laws may in any individual case be disregarded by the same authority by which they might be formally repealed.³ In England, however, the articles of association can be amended or repealed only by a "special resolution" of the shareholders, — that is to say, a resolution passed by a three-fourths vote at one general meeting and confirmed at a subsequent general meeting,⁴ — and until so amended or repealed, they bind the shareholders as well as the directors, and no mere resolution of the shareholders inconsistent with the articles can be given effect.⁵

¹ Supra, § 688.

² *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330; *Henry v. Jackson*, 37 Vt. 431; *Buck v. Troy Aqueduct Co.*, 56 Atl. 285; 76 Vt. 75 (by-law requiring five directors held to be repealed or amended by the custom of the company so as to require only three); *Blair v. Metropolitan Sav. Bank*, 67 Pac. 609; 27 Wash. 192.

Cf. *Richmondville Mfg. Co. v. Prall*, 9 Conn. 487; *Currier v. Continental Life Ins. Co.*, 53 N. H. 538 (headnote inadequate); *National Gross Lodge v. Jung*, 65 Ill. App. 313; *Attorney-General v. Middleton*, 2 Ves. Sr. 327, 330; *Grand Valley Irr. Co. v. Fruita Imp. Co.* (Colo.), 86 Pac. 324, 329, 330-331.

But see *Watson v. Bendigo Bldg. Soc.*, 10 Vict. Rep. (cases at law) 26 (as to "rules" of a building society); *Sperry v. Dransfield*, 2 New Zeal. (Sup. Ct.) 319 (as to "rules" of a building society); *Connell v.*

Stalker, 21 N. Y. Misc. 609, 611-612; 48 N. Y. Supp. 77; *District Grand Lodge v. Cohn*, 20 Ill. App. 335, 344-345; *Campbell v. Watson*, 62 N. J. Eq. 396, 421; 50 Atl. 120 (by-law prescribing duties of directors not repealed by long disobedience on their part); *Coughlin v. Knights of Columbus* (Conn.), 64 Atl. 224.

³ *Bank of Holly Springs v. Pinson*, 58 Miss. 421, 439; 38 Am. Rep. 330; *Samuel v. Holladay*, 1 Woolw. 400, 408-409 (by-law regulating method of convening meetings of directors); *Martino v. Commerce Fire Ins. Co.*, 47 N. Y. Sup. Ct. 520; *Royal Bank of India's Case*, 4 Ch. 252, 258.

Cf. *Sorrentino v. Ciletti*, 75 N. Y. App. Div. 507; 78 N. Y. Supp. 322.

But see *Flaherty v. Benevolent Soc.*, 99 Me. 253; 59 Atl. 58.

⁴ See infra, § 1241.

⁵ *Boschoek Proprietary Co. v. Fuke* (1906), 1 Ch. 148.

§ 729. **Reformation of Mistakes in By-laws.** — In England it has been held that the general power of a court of equity to reform mistakes in written instruments does not extend to the correction of mistakes in the articles of association of a company incorporated under the Companies Acts.¹ The ground of this decision was that the articles of association of an English company are a statutory instrument like the incorporation paper. This reasoning does not apply with the same force to the by-laws of an American corporation.

§ 730. **Waiver of By-laws intended for Company's Benefit.** — The corporation may always waive by-laws that are intended for its benefit,² such as a by-law giving to it a lien on the shares of its members for debts owing by them,³ or a by-law of a mutual life insurance company prescribing a maximum age for applicants for membership.⁴ This principle relates rather to the construction of the by-law than to its validity or efficacy, or to its continuance in force. Any provision in by-laws, by whomsoever adopted, that is clearly intended for the benefit of the company, may be

¹ *Evans v. Chapman*, 86 L. T. Wisc. 162; 18 N. W. 13; *Susquehanna Mut. Fire Ins. Co. v. Elkins*, 381.

² See *Swedish, etc. Mission Soc. v. Lawrence*, 79 Minn. 124; 81 N. W. 756; *McKenney v. Diamond State Loan Ass'n*, 8 Houst. (Del.) 557; 18 Atl. 905; *Delaney v. Delaney*, 175 Ill. 187; 51 N. E. 961; *Independent Order v. Haggerty*, 86 Ill. App. 31; *Burlington Voluntary Relief Dept. v. White*, 41 Nebr. 547; 59 N. W. 747; 43 Am. St. Rep. 701; *Watts v. Equitable Mut. Life Ins. Co.*, 82 N. W. Rep. 441; 111 Iowa 90; *Grand Lodge v. Reneau*, 75 Mo. App. 402; *Metropolitan Acc. Ass'n v. Froiland*, 161 Ill. 30; 43 N. E. 766; 52 Am. St. Rep. 359 (by-law limiting time for suing company waived by refusal to show copy to member on request); *McMahon v. Supreme Tent*, 151 Mo. 522; 52 S. W. 384 (provision for forfeiture of policy in mutual insurance company); *Davidson v. Old People's, etc. Soc.*, 39 Minn. 303; 39 N. W. 803; 1 L. R. A. 482; *Morrison v. Wisconsin Odd Fellows, etc. Ins. Co.*, 59

124 Pa. St. 484; 17 Atl. 24.

Cf. *Priest v. Citizens Mut. Fire Ins. Co.*, 3 Allen (Mass.) 602 (head-note inadequate); *Brewer v. Chelsea Mutual Fire Ins. Co.*, 14 Gray (Mass.) 203.

See also as to waiver of requirements for registration of transfers, *infra*, § 861; *Smith v. People's Mut., etc. Soc.*, 19 N. Y. Supp. 432; 64 Hun 534. As to waiver of other restrictions on transfers of shares, see *infra*, § 949-§ 950.

³ *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447, 460-461; 24 S. W. 129; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330.

Cf. *Currier v. Continental Life Ins. Co.*, 53 N. H. 538; *Supreme Tent v. Volkert*, 25 Ind. App. 627; 57 N. E. 203. See also *infra*, § 957.

⁴ *Wiberg v. Minnesota, etc. Relief Ass'n*, 73 Minn. 297; 76 N. W.

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waived by it; but though this rule is not *per se* objectionable, yet the courts have applied it in some rather doubtful cases. Thus, a by-law of a benefit society requiring members to designate in writing the name of the beneficiary may be waived, so that a person designated as beneficiary by parol, with the company's assent, is entitled to the rights of a beneficiary.¹ So, the fact that a member of a building society is permitted to hold a greater number of shares than is allowed by the by-laws is no defence to an action by the company for dues or assessments on shares so held;² the limitation on the number of shares being for the company's benefit may be waived by it.

§ 731. **Construction of By-laws.** — The rules which govern the construction of by-laws do not differ from those for the construction of other similar instruments. Wherever a code or set of by-laws is in force, all must be construed together, so as to harmonize, if possible, apparent discrepancies.³ By-laws imposing forfeitures or penalties will be strictly construed.⁴ The courts will lean against a construction which would give a by-law a retroactive effect.⁵ We have seen that a long-continued custom in a corporation may have the effect of a by-law or of repealing a previously adopted by-law;⁶ and *a fortiori*, therefore, the usage of the company may be deferred to in the construction of by-laws which in themselves are ambiguous.⁷ But the admission of parol evidence, such as the opinions of officers of the corporation, as to the meaning of an unambiguous by-law is a very different thing, and will not be permitted.⁸

¹ *Hanson v. Minnesota Scandinavian, etc. Ass'n*, 59 Minn. 123; 60 N. W. 1091. 643-644; 44 C. C. A. 93; *Ancient Order v. Brown*, 112 Ga. 545; 37 S. E. 890; *Gundlach v. Germania, etc. Inst.*, 49 How. Pr. (N. Y.) 190 (headnote inadequate); *Roxbury Lodge v. Hocking*, 60 N. J. Law 439; 38 Atl. 693; *Modern Woodmen v. Wieland*, 109 Ill. App. 340; *Taylor v. Modern Woodmen*, 72 Kans. 443; 83 Pac. 1099; *United Workmen v. Haddock*, 72 Kans. 35; *Kaemmerer v. Kaemmerer* (Ill.), 83 N. E. 133.

² *Hagerman v. Ohio, etc. Bldg. Ass'n*, 25 Oh. St. 186.

³ Cf. *Hartford v. Co-operative Homestead Co.*, 128 Mass. 494.

⁴ *Occidental Bldg., etc. Ass'n v. Sullivan*, 62 Cal. 394; *Ottawa Union Bldg. Society v. Scott*, 24 Up. Can. Q. B. 341.

⁵ *Brotherhood of Railroad Trainmen v. Newton*, 79 Ill. App. 500; *Wist v. Grand Lodge*, 22 Oreg. 271; 29 Pac. 610; 29 Am. St. Rep. 603; *Lloyd v. Supreme Lodge*, 98 Fed. 66; 38 C. C. A. 654; *Knights Templars', etc. Co. v. Jarman*, 104 Fed. 638,

⁶ *Supra*, § 688, § 727.

⁷ *McDonough v. Hennepin, etc. Ass'n*, 62 Minn. 122; 64 N. W. 106; *State ex rel. Attorney-General v. Conklin*, 34 Wisc. 21.

⁸ *Brendon v. Worley*, 8 N. Y.

The construction of a written by-law is for the court, rather than the jury, to the same extent as the construction of a written contract, a deed, or a will.¹

§ 732-§ 735. *Constructive Notice of By-laws.*

§ 732. **Strangers to the Company.** — Of the ordinary American by-laws, strangers to the company, according to the almost uniform current of authority, are not affected with constructive notice. Indeed, this feature is one of the chief infirmities of the American system of by-laws. As the by-laws are not matter of record, strangers could not be charged with constructive knowledge of them without the greatest injustice.² Thus, where the by-laws contain a limitation upon the powers of some officer or agent of the company, a stranger who contracts with him is not affected by the limitation without actual notice thereof.³ Of

Misc. 253; 28 N. Y. Supp. 557; *Thomas v. Societa Italiana*, 10 N. Y. Misc. 746; 31 N. Y. Supp. 815; *Badesch v. Congregation Bros.*, 23 N. Y. Misc. 160; 50 N. Y. Supp. 958.

¹ Cf. *State ex rel. Attorney-General v. Conklin*, 34 Wisc. 21; *Traders' Mut. Life Ins. Co. v. Humphrey*, 109 Ill. App. 246, affirmed, 69 N. E. 875.

² So, the by-laws of a Canadian company, as a learned judge has pointed out, "are not public property. They concern matters of internal management. Those who deal with the company have no means of access to them, no right to pry into the company's archives or interrogate its officials." *Montreal, etc. Power Co. v. Robert* (1906), A. C. 196, 202-203 (headnote inadequate).

³ *Royal Bank of India's Case*, 4 Ch. 252, 262; *Montreal, etc. Power Co. v. Robert* (1906), A. C. 196, 202-203 (by-law fixing a quorum of directors—headnote inadequate); *Pine Beach, etc. Corp. v. Columbia Amusement Co.* (Va), 56 S. E. 822; *Russell v. Washington Sav. Bank*, 23 App. D. C. 308; *Arapahoe, etc. Co.*

v. Stevens, 13 Colo. 534; 22 Pac. 823; *Moyer v. East Shore Terminal Co.*, 41 S. Car. 300; 19 S. E. 651; 44 Am. St. Rep. 709; 25 L. R. A. 48; *Trawick v. Peoria, etc. Ry. Co.*, 68 Ill. App. 156; *Ten Broek v. Boiler Compound Co.*, 20 Mo. App. 19; *Smith v. Martin Anti-Fire, etc. Co.*, 19 N. Y. Supp. 285; 47 N. Y. St. Rep. 26; *Fay v. Noble*, 12 Cush. 1; *Smith v. Smith*, 62 Ill. 493; *Wait v. Smith*, 92 Ill. 385; *Ward v. Johnson*, 95 Ill. 215, 248; *Union Mut. Life Ins. Co. v. White*, 106 Ill. 67; *Barnes Bros. v. Coal Co.*, 101 Tenn. 354; 47 S. W. 498; *Metropole Bath Co. v. Garden City Fan Co.*, 50 Ill. App. 681; *Rathbun v. Snow*, 123 N. Y. 343; 25 N. E. 379; 10 L. R. A. 355 (semble); *Perry v. Council Bluffs, etc. Co.*, 67 Hun (N. Y.) 456; 22 N. Y. Supp. 151; *Milledgeville Water Co. v. Edwards*, 121 Ga. 555; 49 S. E. 621; *Lyndon Sav. Bank v. International Co.*, 54 Atl. 191; 75 Vt. 224 (by-law requiring promissory notes of the company to be signed by treasurer and countersigned by two directors); *Powers v. Schlicht Heat, etc. Co.*, 23 N. Y. App. Div. 380; 48 N. Y. Supp. 237;

course, a by-law may appoint an agent with such closely limited authority, or may define the powers of officers in such a way, that acts clearly in excess of the authority so marked out will not bind the corporation; but this is not because persons who deal with such agents or officers are charged with notice of the limitations on their powers contained in the by-laws, but because an agent who acts altogether beyond his authority does not bind his principal whether the third party does or does not know the limits of the agent's powers.¹ As strangers are not chargeable with notice of the provisions of by-laws, a policy of insurance issued by a benefit society, the terms of which conflict with the by-laws of the society, may nevertheless be binding according to its terms.² So, where the by-laws of a fire insurance company establish different rates for different kinds of property, even a deliberate mis-classification of property by the directors will not necessarily vitiate the policy.³

§ 733. **Shareholders.** — Indeed, there is authority for the view that even members of the corporation are not chargeable with constructive notice of its by-laws.⁴ Thus, a transferee of

affirmed short in 165 N. Y. 662; 59 N. E. 1129; *Equitable Endowment Ass'n v. Fisher*, 71 Md. 430; 18 Atl. 808; *Produce Exchange Trust Co. v. Bieberbach*, 58 N. E. 162; 176 Mass. 577.

But see *Adriance v. Roome*, 52 Barb. (N. Y.) 399, 411; *Haden v. Farmers', etc. Fire Ass'n*, 80 Va. 683, 691; *Dabney v. Stevens*, 2 Sweeney (N. Y.) 415; 40 How. Pr. (N. Y.) 341 (semble); *Bohm v. Loewer's, etc. Brewery Co.*, 9 N. Y. Supp. 514; 16 Daly (N. Y.) 80; *DeBost v. Palmer Co.*, 1 How. Pr. n. s. (N. Y.), 501; 35 Hun 386; *Harvey v. Schuylkill Real Estate, etc. Co.*, 24 Pa. Co. Ct. Rep. 593; *Millward-Cliffe Cracker Co.'s Estate*, 161 Pa. St. 157; *Worthington v. Skuylkill Electric Ry. Co.*, 195 Pa. St. 211; 45 Atl. 927; *Kansas City Hay Press Co. v. Devo*, 72 Fed. 717, 721 (headline inadequate).

Cf. *Tres Palacios, etc. Co. v. Eidman* (Tex.), 93 S. W. 698 (holding that by-law restricting power of

agent to bind company is admissible in evidence in favor of corporation when plaintiff counts on an actual contract and not on an estoppel — *sed quare*); *Northwestern Packing Co. v. Whitney* (Cal.), 89 N. W. 981.

¹ Cf. *Carney v. N. Y. Life Ins. Co.*, 162 N. Y. 453; 57 N. E. 78; 76 Am. St. Rep. 347; 49 L. R. A. 471; *Davis v. Rockingham Investment Co.*, 89 Va. 290; 15 S. E. 547; *Twelfth Street Market Co. v. Jackson*, 102 Pa. St. 269; *Railway Equipment, etc. Co. v. Lincoln Nat. Bank*, 82 Hun (N. Y.) 8, 11; 31 N. Y. Supp. 44.

² *Davidson v. Old People's, etc. Soc.*, 39 Minn. 303; 39 N. W. 803; 1 L. R. A. 482. See also *Fitzgerald v. Equitable, etc. Life Ass'n*, 3 N. Y. Supp. 214; 18 N. Y. St. Rep. 914.

³ *Union Mutual Fire Ins. Co. v. Keyser*, 32 N. H. 313; 64 Am. Dec. 375. See also *Campbell v. Merchants, etc. Ins. Co.*, 37 N. H. 35; 72 Am. Dec. 324.

⁴ *Northwestern Life Ins. Co. v.*

shares is not affected with constructive notice of a by-law purporting to create a lien on the shares in favor of the company.¹ So, a person who lends money on the security of a share-certificate signed and issued by the company's treasurer is not chargeable with notice of by-laws limiting the powers of the treasurer in that regard.²

§ 734. **Directors and Officers.** — The directors and higher officers whose duties require an intimate knowledge of the company's internal affairs may fairly be charged with constructive notice of the by-laws,³ or at least with such by-laws as have been duly published and entered in the company's minutes. At any rate, knowledge will be presumed,⁴ and the burden of proving ignorance will rest on the directors. It would seem that a subordinate employee of the company cannot be similarly affected by such presumptive or constructive notice.⁵

§ 735. **Persons who are in act of becoming or who subsequently become Members or Officers.** — In determining whether a person is to be charged with constructive notice of a company's by-laws as a member or otherwise, some authorities maintain that regard must be had to his status at the time the contract was made, and that it is immaterial whether the effect of the

Erlenkoetter, 90 Ill. App. 99; *McKenney v. Diamond State Loan Ass'n*, 8 Houst. (Del.) 557; 18 Atl. 905; *Underhill v. Santa Barbara, etc. Co.*, 93 Cal. 300, 311-312; 28 Pac. 1049 (semble); *Williamson v. Eastern Bldg., etc. Ass'n*, 54 S. Car. 582; 32 S. E. 765; 71 Am. St. Rep. 822.

But see *Pfister v. Gerwig*, 122 Ind. 567; 23 N. E. 1041; *Harvey v. Grand Lodge*, 50 Mo. App. 472, 477; *Bauer v. Samson Lodge*, 102 Ind. 262; 1 N. E. 571; *Came v. Brigham*, 39 Me. 35, 38; *Crittenden v. Southern Home Bldg., etc. Ass'n*, 111 Ga. 266; 36 S. E. 643; *Coles v. Iowa State, etc. Ins. Co.*, 18 Iowa 425; *Mitchell v. Lycoming Mut. Ins. Co.*, 51 Pa. St. 402; *People's Bldg., etc. Ass'n v. Purdy*, 78 Pac. (Colo.) 465; *Columbia Bldg., etc. Ass'n v. Junquist*, 111 Fed. 645; *Richardson v. Devine* (Mass.), 79 N. E. 771.

¹ *Driscoll v. West Bradley, etc. Ins. Co.*, 26 La. Ann. 13.

Co., 59 N. Y. 96; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330. See *infra*, § 956 and *supra*, § 706.

² *Tome v. Parkersburg Branch R. R. Co.*, 39 Md. 36, 74-75; 17 Am. Rep. 540.

³ *Darrah v. Wheeling Ice, etc. Co.*, 50 W. Va. 417; 40 S. E. 373.

Cf. *Jones v. Vance Shoe Co.*, 92 Ill. App. 158; *Mutual Life Ins. Co. v. McSherry*, 68 Md. 41, 45-46 (headnote inadequate); 11 Atl. 577; *Beers v. New York Life Ins. Co.*, 66 Hun (N. Y.) 75; 20 N. Y. Supp. 788.

⁴ *Hunter v. Sun Mut. Ins. Co.*, 26 La. Ann. 13; *Ellis v. N. C. Institution*, 68 N. Car. 423.

⁵ *Moyer v. East Shore Terminal Co.*, 41 S. Car. 300; 19 S. E. 651; 44 Am. St. Rep. 709; 25 L. R. A. 48.

But see *Hunter v. Sun Mutual*

contract may be to make him an officer or member of the company;¹ but the weight of authority supports a different view on this point.² At all events, the rights of a party under a contract with the corporation made in disregard of by-laws of which he had no notice will not be affected by the fact that subsequently by an independent transaction he becomes a member of the company.³

§ 736. **Who are subject to By-laws.** — The power of a corporation to enforce its regulations by penalties or forfeitures must necessarily be confined to members, and cannot extend to strangers who have never consented to be bound by its rules. To be sure, officers and agents, and others who contract with the company with knowledge of its regulations, must be deemed to have agreed, so far as their agency or contract is concerned, to abide thereby.⁴ Indeed, if a person who contracts with a corporation has actual notice of the terms of by-laws affecting his contract or the authority of the agents or officers of the company by whom it was made to enter into it — for example, if the contract is in writing and expressly incorporates the by-laws in question — it has even been said that he is bound by all the provisions of the by-laws to the same extent as if they had been statutes of the state.⁵ Only shareholders, however, are permanently subject to the by-laws, and subject to them as rules prescribed by a lawgiver.⁶ Moreover, even members of

¹ *Moyer v. East Shore Terminal Co.*, 41 S. Car. 300; 19 S. E. 651; 44 Am. St. Rep. 709; 25 L. R. A. 48. 7 L. R. A. 822. See also books on mutual insurance.

² *Wait v. Smith*, 92 Ill. 385.

³ *Cummings v. Webster*, 43 Me. 192, 197. Cf. *Bank of Wilmington v. Wollaston*, 3 Harr. (Del.) 90; *Sanitary Can Co. v. Mullins*, 86 N. Y. App. Div. 450; 83 N. Y. Supp. 918.

⁴ *Hunter v. Sun Mutual Ins. Co.*, 26 La. Ann. 13; *Ellis v. N. C. Institution*, 68 N. Car. 423; *Jones v. Vance Shoe Co.*, 92 Ill. App. 158; *Darrah v. Wheeling Ice, etc. Co.*, 50 W. Va. 417; 40 S. E. 373; *Colpe v. Jubilee Mining Co.* (Cal.), 84 Pac. 324; *Douglass v. Merchants' Ins. Co.*, 118 N. Y. 484; 23 N. E. 806; 19 Johns (N. Y.) 115. Cf. *Seneca*

⁵ *Cannon v. Farmers' Mut. Fire Ass'n*, 58 N. J. Eq. 102; 43 Atl. 281; *Amesbury v. Bowditch Mut. Fire Ins. Co.*, 6 Gray (Mass.) 596, 603.

⁶ Cf. *Nute v. Hamilton Mut. Ins. Co.*, 6 Gray (Mass.) 174.

⁷ *Mechanics, etc. Bank v. Smith*, 6 Gray (Mass.) 174.

the corporation are not subject to the corporate jurisdiction except in their capacity as members. Thus a by-law attempting to impose a fine on members for non-payment of interest on debts owing by them to the corporation has been held void.¹ On the other hand, the application of this principle to the members of such corporations as mutual insurance companies, the members of which occupy a dual relation, as members and as creditors, will be found very difficult.

§ 737. **Who may take Advantage of By-laws.** — Conversely, a stranger to the company can, in general, acquire no right of action by virtue of the by-laws.² As was said by a Massachusetts judge: "The office of a by-law is to regulate the conduct and define the duties of the members toward the corporation and between themselves. So far as its provisions are in the nature of contract, the parties thereto are the members of the association, as between themselves; or the corporation upon the one side, and its individual members upon the other. The right of any third party, stranger to the association, to establish a legal claim through such a by-law, must depend upon the general principle applicable to express contracts."³ Thus, a stranger cannot sue to recover a penalty which a by-law directs to be paid to him by some delinquent member.⁴ Upon the same principle, a provision in the articles of association of an English company purporting to adopt a contract made by promoters on behalf of the company prior to its incorporation will not enable the other party to the contract to sue the company thereon.⁵

§ 738. **Pleading and Proof of By-laws.** — In pleading, the degree of particularity necessary in mentioning or setting out by-laws depends so largely on the local system of pleading that little can be profitably said on the subject.⁶ In an action of debt to recover a fine imposed by virtue of a by-law, the terms

County Bank v. Lamb, 26 Barb. (N. Y.) 595, 597-598; *State v. Overton*, 24 N. J. Law 435, 440-442; 61 Am. Dec. 671.

¹ *Hagerman v. Ohio Bldg., etc. Ass'n*, 25 Oh. St. 186, 203; *Parker v. U. S. Bldg., etc. Ass'n*, 19 W. Va. 744.

² *Flint v. Pierce*, 99 Mass. 68; 96 Am. Dec. 691.

³ *Flint v. Pierce*, 99 Mass. 68, 70-71; 96 Am. Dec. 691; per Wells,

⁴ *Bodwic v. Fennell*, 1 Wils. 233;

Cf. *Graves v. Colby*, 9 Ad. & E. 356.

⁵ *Supra*, § 328.

⁶ Cf. *Hingston v. Montgomery* (Mo.), 97 S. W. 202, 205 (where a by-law which was not pleaded was enforced).

of the by-law must be set out in the declaration; for otherwise it may be held bad, at least on special demurrer.¹

By-laws must be proved like other resolutions of a corporation.² If in actions at law the existence of a by-law is in dispute, its adoption must, where the evidence is conflicting or inconclusive, be left to the jury.³

¹ *Master, etc. of Feltmakers*, 1 B. & P. 98.

² *Cotton Jammers, etc. Ass'n v. Taylor*, 23 Tex. Civ. App. 367; 56

³ See Boisot on By-laws, 2d ed., S. W. 553. § 158, § 159.

CHAPTER XIII

PAYMENT FOR SHARES

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§ 739. **Liability to contribute to Company's Capital — Scheme of Treatment.** — The status of shareholder carries with it certain rights and certain obligations. Chief among the latter, at least according to the theory of the law, is the obligation of contributing to the capital of the company an amount equal to the nominal value of the shares. The nature of this obligation and the methods of enforcing it should first be considered, and subsequently the question should be considered how far this normal obligation may be departed from or varied by special agreement between the shareholders and the company.

§ 740-§ 773. NORMAL LIABILITY.

§ 740. **In general — Liability to pay on Call.** — Normally every shareholder is bound to pay in cash the par value of the shares held by him, in such instalments and at such times as the company may call for the same.¹ In the absence of some special regulation or agreement, an applicant for shares is not bound to pay a deposit on allotment or issue of the shares, but is merely bound to pay on call.² Payment of deposits on application or allotment or both is, however, often required by statute. Under such statutes, the authorities are in conflict whether non-payment of the required deposit renders the subscription wholly void.³ If by statute or by valid internal regulations of the company

¹ But see *Harris v. Gateway Land Co.*, 29 So. 611; 128 Ala. 652.

² *Alexander v. Automatic Telephone Co.* (1900), 2 Ch. 56.

³ See *supra*, § 200.

payment is required at certain fixed periods, there is then no necessity for a call;¹ and *a fortiori* the same is true where the time of payment is fixed in the subscription itself.²

§ 741-§ 742. *Nature of Liability before and after Call.*

§ 741. **In general — Effect of call — Liability as for a Debt.** — Until a call is made, the liability of the shareholders is potential merely;³ but immediately upon the call the shareholders become debtors to the company for the amount of the call.⁴ From that time on the obligation scarcely differs from any other debt.⁵ To be sure, in one or two New England states, it has been held that a corporation cannot sue a shareholder in debt or assumpsit to recover the amount of a call, unless his subscription for the shares contained an express promise to pay for them;⁶ but this doctrine is unsupported by any sound principle, has been uniformly discountenanced by the best text-writers,⁷ and is opposed to the overwhelming weight of authority in the common-law world.⁸ The remedy of the company by forfeiture of the

¹ *Waukon, etc. R. R. Co. v. Dwyer*, 49 Iowa 121.

Cf. *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 294, 300.

See also *infra*, § 774, and § 783.

² *Williams v. Matthews*, 103 Va. 180; 48 S. E. 861. Cf. *infra*, § 783.

See also *California, etc. Co. v. Callender*, 94 Cal. 120, 127-128; 29 Pac. 859; 28 Am. St. Rep. 99 (holding that where a subscription by its terms is payable "at such time and in such manner as may be determined by the board of directors," action may be brought without proving a call complying with the statutory formalities).

³ *Cawley & Co.*, 42 Ch. D. 209; *Ex parte Rudolph*, 11 W. R. 806; *South Milwaukee Co. v. Murphy*, 112 Wisc. 614; 88 N. W. 583; 58 L. R. A. 82.

But see *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146.

As to the right of a creditor to enforce payment from shareholders though no call has been made, see

Hatch v. Dana, 101 U. S. 205, 214-215; *Glen Iron Works*, 17 Fed. 324; affirmed, 20 Fed. 674; *Cleveland Rolling-Mill Co. v. Texas, etc. Ry. Co.*, 27 Fed. 250. Cf. *infra*, § 807.

⁴ A call is "owing" from the time it is made although not payable until afterwards. *Faura Electric, etc. Co. v. Phillipart*, 58 L. T. 525.

⁵ Cf. *Crawford v. Roney* (Ga.), 55 S. E. 499 (holding that where call is proved, onus of proving payment is cast upon shareholder as in any other case of debt).

⁶ *Atlantic Cotton Mills v. Abbott*, 9 Cush. 423; *Katama Land Co. v. Jernegan*, 126 Mass. 155; *Kennebec, etc. R. R. Co. v. Kendall*, 31 Me. 470; *Jay Bridge Co. v. Woodman*, 31 Me. 573.

Cf. *Penobscot, etc. R. R. Co. v. Dunn*, 39 Me. 587, 594 (agreement to "take and fill" a certain number of shares).

⁷ E. g. 1 Morawetz on Priv. Corps., 2d ed., § 128-§ 129.

⁸ *Hughes v. Antietam Mfg. Co.*,

merely administrative, and may therefore be left to the company's executive officers. If no time is fixed for payment, the call is payable immediately or after the expiration of the required notice at the option of the shareholder.¹ On the other hand, a resolution calling for payment either in cash or in "land contracts," without stating who should have the option as to the mode of payment, is too indefinite to constitute a valid call.² A provision in articles of association requiring the directors to specify the person to whom a call should be payable has been construed to apply only to cases where the call is payable at some place other than the company's registered office.³

§ 747-§ 752. *Notice of Calls.*

§ 747. **Whether Notice is necessary.** — A call is generally not enforceable until some notice thereof be given to the shareholders. Such notice is often explicitly required by statute⁴ or the company's regulations. Upon principle, it is submitted that notice is necessary even without any express requirement,⁵ but the contrary doctrine is laid down as settled law by some

Co. v. Thrall, 35 Vt. 536; *Great North of England Ry. Co. v. Bid-dulph*, 7 M. & W. 243; *American Pastoral Co. v. Gurney*, 61 Fed. 41; *Western Imp. Co. v. Des Moines Nat. Bank*, 103 Iowa 455; 72 N. W. 657.

Cf. *Andrews v. Ohio, etc. R. R. Co.*, 14 Ind. 169; *Banet v. Alton, etc. R. Co.*, 13 Ill. 504 (headnote inadequate); *Hays v. Pittsburgh, etc. R. Co.*, 38 Pa. St. 81 (in which cases the amount of the call as well as the place for payment was left undetermined by the resolution); *Ruck v. Caledonia Silver Mining Co.* (Cal.), 92 Pac. 194 (statute requiring that call state place of payment held mandatory).

¹ *Baile v. Calvert Coll., etc. Soc.*, 47 Md. 117, 124. Cf. *Western Imp. Co. v. Des Moines Nat. Bank*, 103 Iowa 455; 72 N. W. 657.

But see *Cawley & Co.*, 42 Ch. D. 209 (where the court held that a resolution for a call leaving the date

for payment blank could not amount to a call until the blank was filled).

² *North Milwaukee Town Site Co. v. Bishop*, 103 Wisc. 492; 79 N. W. 785; 45 L. R. A. 174.

³ *Re Kozminsky*, 16 Vict. L. R. 137.

⁴ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316; *Scarlett v. Academy of Music*, 43 Md. 203; *Macon, etc. R. Co. v. Vason*, 57 Ga. 314, 318; *Carlisle v. Cahawba, etc. R. R. Co.*, 4 Ala. 70.

Cf. *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536.

⁵ *Miles v. Bough*, 3 G. & D. 119; *Hughes v. Antietam Mfg. Co.*, 34 Md. 316, 330-331; *Germania Iron, etc. Co. v. King*, 94 Wisc. 439; 69 N. W. 181; 36 L. R. A. 51 (semble); *Alabama, etc. R. R. Co. v. Rowley*, 9 Fla. 508.

Cf. *Maltby v. Northwestern Va. R. R. Co.*, 16 Md. 422; 10 Cyc. p. 496 (per Judge Thompson).

standard American text-writers,¹ and is supported by some adjudicated cases.²

§ 748. **Kind of Notice.** — Usually, notice by advertisement is provided for by statute or by the company's regulations; and perhaps such notice would be sufficient in the absence of any such provision.³ At all events, unless the matter is governed by some positive regulations, any reasonable notice will be sufficient.⁴ In the absence of an explicit regulation on the subject, the notice need not specify the place for payment.⁵ Oral notice is good unless written notice be affirmatively required.⁶ Explicit regulations should, however, be observed.⁷ For example, where an act of incorporation provided that all notices of every sort should be signed by three directors or by their clerk by their order, a notice of a call must conform to those requirements.⁸ Thus, where the statute requires personal demand or notice by publication, notice by posting a letter in the public mails is not sufficient.⁹ On the other hand, where the shareholder receives actual notice of the call, the fact that the notice may not have been in the required form is perhaps immaterial.¹⁰ If the statute con-

¹ 1 Morawetz on Priv. Corps., 2d ed., § 147; 2 Clark & Marshall on Priv. Corps., § 500.

² *Eakright v. Logansport, etc. R. R. Co.*, 13 Ind. 404, 408 (headnote inadequate); *Heaston v. Cincinnati, etc. R. R. Co.*, 16 Ind. 275; 79 Am. Dec. 430; *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451; *Eastern Plank Road Co. v. Vaughan*, 20 Barb. 155; *United Fruit Growers Co. v. Eisner*, 22 N. Y. App. Div. 1, 5; 47 N. Y. Supp. 906; *Hill v. Nisbet*, 100 Ind. 341, 356.

³ *Hall v. U. S. Ins. Co.*, 5 Gill (Md.) 484.

But see *Lake Ontario, etc. R. R. Co. v. Mason*, 16 N. Y. 451, 463-464 (semble); *Alabama, etc. R. R. v. Rowley*, 9 Fla. 508. As to what is a reasonable notice by publication, see *Moore v. Wheal Byjerkerno Tin Mining Co.*, 17 Vict. L. R. 680.

⁴ Cf. *National Ins. Co. v. Egleson*, 29 Grant (Can.) 406.

⁵ *Vawter v. Franklin College*, 53 Ind. 88.

⁶ *Smith v. Plank Road Co.*, 30 Ala. 650.

⁷ As to what is a shareholder's "regular address" within the meaning of a by-law requiring notice to be sent to him there, see *Bange v. Supreme Council (Mo.)*, 105 S. W. 1092.

⁸ *Miles v. Bough*, 3 G. & D. 119, 132.

⁹ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316, 331.

Cf. *Braddock v. Philadelphia, etc. R. R. Co.*, 45 N. J. Law 363; *Morris v. Metalline Land Co.*, 164 Pa. St. 326; 30 Atl. 240; 44 Am. St. Rep. 614; 27 L. R. A. 305.

¹⁰ *British Sugar Co.*, 3 K. & J. 408; *Mississippi, etc. R. R. Co. v. Gaster*, 20 Ark. 455.

Cf. *Jones v. Sisson*, 6 Gray (Mass.) 288; *Sands v. Sanders*, 26 N. Y. 239; *Grand Valley Irr. Co. v. Fruita Imp. Co. (Colo.)*, 86 Pac. 324, 329, 330-331; 1 Morawetz on Priv. Corps., 2d ed., § 147, p. 148.

But see *Morris v. Metalline Land*

templates "such notice as may be prescribed by the by-laws," nevertheless, if no by-laws on the subject are adopted, any reasonable notice will be sufficient.¹ How far the terms of the notice must be approved by the directors and how far such details may be committed to executive officers will depend very largely upon the terms of the laws and regulations governing the company.²

§ 749. **Length of Notice.** — Provisions as to the length of notice are mandatory. Where notice of, say, twenty-one days is required, there must be twenty-one clear days exclusive both of the *terminus a quo* and the *terminus ad quem*; so that even in a leap year notice given on February 9th of a call payable on March 1st would be invalid.³ However, a call may by its terms be payable on a date prior to the expiration of the stipulated length of notice, although it will not be collectible until afterwards.⁴ Where "at least sixty days' notice" by publication is required, the notice need not be published daily throughout the sixty days, but if the first publication be sixty days before the time fixed for payment, that is enough.⁵

§ 750. **To whom Notice should be given.** — Notice of a call addressed to a deceased member at his late address is good.⁶ No notice need be given to a person who as director was present at the meeting at which the call was made.⁷ In the case of shares

Co., 164 Pa. St. 326; 30 Atl. 240; 44 Am. St. Rep. 614; 27 L. R. A. 305.

¹ *Danbury, etc. R. R. Co. v. Wilson*, 22 Conn. 435.

But see *Germania Iron, etc. Co. v. King*, 94 Wisc. 439; 69 N. W. 181; 36 L. R. A. 51 (holding that no call could be collected until the adoption of by-laws prescribing the notice to be given); *North Milwaukee Town Site Co. v. Bishop*, 103 Wisc. 492; 79 N. W. 785; 45 L. R. A. 174 (a similar case).

² See *Sheffield, etc. Ry. Co. v. Woodcock*, 7 M. & W. 574; *London, etc. Ry. Co. v. Fairclough*, 2 M. & Gr. 674.

³ *Re Jennings*, 1 Ir. Ch. 236, 240-241.

Cf. *National Ins. Co. v. Egleson*, 29 Grant (Can.), 406, 412.

⁴ *Scarlett v. Academy of Music*, 46 Md. 132.

Cf. *People's Home Savings Bank v. Rauer* (Cal.), 84 Pac. 329.

⁵ *Muskingum Valley Turnpike Co. v. Ward*, 13 Oh. 120; 42 Am. Dec. 191.

⁶ *New Zealand Gold Co. v. Peacock* (1894), 1 Q. B. 622.

Cf. *Allen v. Gold Reefs of West Africa* (1900), 1 Ch. 656.

As to notice to the representatives of a deceased shareholder, see further, *South Milwaukee Co. v. Murphy*, 112 Wisc. 614; 88 N. W. 583; 58 L. R. A. 82. See also *infra*, § 976 et seq.

⁷ *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102.

Cf. *Graebner v. Post*, 119 Wisc. 392; 96 N. W. 783; 100 Am. St. Rep. 890.

owned by co-partners, or perhaps by any two persons jointly, notice to one is notice to all.¹

§ 751. **Waiver of Notice by repudiating Liability.** — It has been held that a shareholder who altogether repudiates ownership of the shares and the attendant liability, thereby waives notice of all subsequent calls.² Although no reason was assigned by the court for this conclusion, doubtless the basis of the doctrine is that notice need not be given to one who has shown that the notice will be useless.

§ 752. **Effect of Lack of Notice.** — A shareholder who has received regular notice of a call cannot defend an action therefor because other shareholders may not have been duly notified.³ This rule is proper, and indeed almost necessary; yet one should observe that it enables directors, if they should be so minded, to evade the rule which requires calls to be uniform on all shareholders, merely by omitting to give notice to those shareholders whom they desire to favor.⁴

§ 753–§ 757. *Time and Amount of Calls.*

§ 753. **In general — Discretion of Company.** — The object of the law in requiring subscriptions to the capital of a corporation to be paid in instalments when called for by the company is of course to enable the company to call in only so much of its capital as its necessities from time to time may require. Nevertheless, the company or the directors are the exclusive judges of whether or not the corporation needs the capital called up; and a shareholder, therefore, cannot resist payment of a call because the money is not in fact needed by the company.⁵ So,

¹ *National Ins. Co. v. Egleson*, 29 Grant (Can.) 406 (semble).

² *Cass v. Pittsburgh, etc. Ry. Co.*, 80 Pa. St. 31.

³ *Shackleford, Ford & Co. v. Dangerfield, L. R.* 3 C. P. 407, 411; *Baile v. Calvert College, etc. Soc.*, 47 Md. 117, 125 (headnote inadequate); *Hastings Lumber Co. v. Edwards*, 75 N. E. 57; 188 Mass. 587.

Cf. *Hambleton v. Glenn*, 72 Md. 331; 20 Atl. 115.

⁴ Cf. 1 Morawetz on Priv. Corps., 2d ed., § 154.

⁵ *Odessa Tramways v. Mendel*, 8 Ch. D. 235; *Penobscot R. R. Co. v. White*, 41 Me. 512, 518–520; 66 Am. Dec. 257; *Visalia, etc. R. R. Co. v. Hyde*, 110 Cal. 632; 43 Pac. 10; 52 Am. St. Rep. 136 (where the unsuccessful defence was that the call was made for the purpose of paying liabilities contracted before defendant became a shareholder); *Judah v. American, etc. Ins. Co.*, 4 Ind. 333; *Chouteau Ins. Co. v. Floyd*, 74 Mo. 286; *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413; 15 Pac.

too, the amount of calls is wholly discretionary with the company. To be sure, in one case it was held that the corporation could not call in the whole amount of the stock at once;¹ but this decision is opposed to the reason of the law and to other decided cases.²

§ 754. **Calls before Company authorized to commence Business — Defence of incomplete Subscription of Capital.** — On the other hand, except for preliminary expenses, a corporation can have no need of capital until it is competent to commence business; and until that time should have no power to make calls upon its shareholders for the purpose of engaging in business.³ We have seen above that according to the American rule a corporation may not commence business unless by unanimous consent until its authorized capital has been fully subscribed.⁴ Accordingly, in America, until the whole authorized capital of the company has been subscribed, no call can be made,⁵ except for the pur-

659; 3 Am. Rep. 169; *Nashua Savings Bank v. Anglo-American Co.*, 189 U. S. 221; 23 Sup. Ct. 517 (leaving the question open whether an assessment made unnecessarily and in bad faith would be enforceable); *Anglo-American Land, etc. Co. v. Dyer*, 181 Mass. 593; 64 N. E. 416; 92 Am. St. Rep. 437; *Fitzgerald's Estate v. Union Sav. Bank*, 90 N. W. 994; 65 Nebr. 97.

Cf. *Bailey v. Birkenhead, etc. Ry. Co.*, 12 Beav. 433; *Bank of China v. Morse*, 168 N. Y. 458; 85 Am. St. Rep. 676; 61 N. E. 774; 56 L. R. A. 139.

¹ *Spangler v. Indiana, etc. Ry. Co.*, 21 Ill. 276.

² *Haun v. Mulberry, etc. Co.*, 33 Ind. 103; *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413; 15 Pac. 659; 3 Am. Rep. 169.

³ But see *United Fruit Growers Co. v. Eisner*, 22 N. Y. App. Div. 1, 6-7; 47 N. Y. Supp. 906.

⁴ *Supra*, § 177.

⁵ *Hughes v. Antietam Mfg. Co.*, 34 Md. 316; *Salem Mill Dam Corp. v. Ropes*, 6 Pick. (Mass.) 23; *Denny Hotel Co. v. Schram*, 6 Wash. 134; 32 Pac. 1002; 36 Am. St. Rep. 130;

Livesey v. Omaha Hotel Co., 5 Nebr. 50; *Haskell v. Worthington*, 94 Mo. 560; 7 S. W. 481; *Allman v. Havana, etc. R. R. Co.*, 88 Ill. 521; *Galveston Hotel Co. v. Bolton*, 46 Tex. 633 (notwithstanding a statute which provided that the corporation might be "organized" when part only of the capital should be subscribed); *New Hampshire Central R. R. v. Johnson*, 30 N. H. 390; 64 Am. Dec. 300; *Proprietors of Cabot, etc. Bridge*, 6 Cush. (Mass.) 50.

But see *Hamilton, etc. Co. v. Rice*, 7 Barb. (N. Y.) 157, 166-167; *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102; *Jewett v. Valley Ry. Co.*, 34 Oh. St. 601.

This rule has no application if the company is expressly authorized by statute to commence business before the capital is completely taken. 1 Morawetz on Priv. Corps., 2d ed., § 140; *Jewett v. Valley Ry. Co.*, 34 Oh. St. 601.

Calls may be made upon subscribers to the original capital although the capital has been increased and the new shares have not been fully subscribed. *McCoy v. World's Columbian Exposition*, 186 Ill. 356; 57

pose of defraying preliminary expenses.¹ In England, however, inasmuch as a company may, except where prohibited by statute, commence business before its capital is subscribed, the rule just stated probably does not prevail;² and so, too, whenever in the United States a corporation is authorized to commence business before its capital is fully subscribed, it may levy calls upon the shareholders as soon as it is authorized to start business.³ Moreover, in America, the defence of non-complete subscription of the capital is always one which may be waived either expressly or by participating in the commencement or transaction of business by the company with knowledge of the incomplete subscription of capital.⁴ In order to have that effect, however, the

N. E. 1043; 78 Am. St. Rep. 288. Cf. *supra*, § 589.

A requirement that the capital must be subscribed by "responsible persons" is satisfied if the subscribers are *bona fide* believed to be solvent. *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; 63 Am. Dec. 654; *Penobscot R. R. Co. v. White*, 41 Me. 512; 66 Am. Dec. 257.

¹ *Salem Mill Dam Corp. v. Ropes*, 6 Pick. (Mass.) 23; 1 Morawetz on Priv. Corps., 2d ed., § 139.

² *Ornamental Pyrographic Co. v. Brown*, 2 H. & C. 63; *Re Jennings*, 1 Ir. Ch. 236, 241-243; *Mandel v. Swan Land Co.*, 154 Ill. 177, 188; 40 N. E. 462; 45 Am. St. Rep. 124; 27 L. R. A. 313 (governed by the law of Great Britain); *London, etc. Ass. Co. v. Redgrave*, 4 C. B., N. S., 524.

But cf. *Howbeach Coal Co. v. Teague*, 5 H. & N. 151; *Elder v. New Zealand Co.*, 30 L. T. 285; *Pitchford v. Davis*, 5 M. & W. 2; *Galvanized Iron Co. v. Westoby*, 8 Ex. 17; *North Stafford Steel, etc. Co. v. Ward*, L. R. 3 Ex. 172 (where the articles provided that in case all the shares should not be allotted the existing subscribers should, if the directors should so declare, continue associated for the objects of the company, and a call made without any previous resolution of the directors for con-

tinuing the business notwithstanding the incomplete subscription, was held void); Lindley on Companies, 6th ed., 576-577 (where the learned author states the English law in substantial accord with the American law).

Even where the subscription of a certain proportion of the capital of a railway company is expressly made a condition to the right of the company to exercise its powers, the Court of Exchequer held that a call might be made before that amount of capital was taken. *Waterford, etc. Ry. Co. v. Dalbiac*, 6 Eng. Ry. Cas. 753; 6 Ex. 443. But see contra: *Norwich, etc. Navigation v. Theobald*, 1 Moody & M. 151.

³ *Hunt v. Kansas, etc. Bridge Co.*, 11 Kans. 412; *Willamette Freighting Co. v. Stannus*, 4 Oreg. 261; *Nichols v. Burlington, etc. Co.*, 4 G. Greene (Iowa) 42; *Boston, etc. R. Co. v. Wellington*, 113 Mass. 79.

⁴ *Stillman v. Dougherty*, 44 Md. 380; *Hager v. Cleveland*, 36 Md. 476; *Anderson v. Railroad*, 91 Tenn. 44; 17 S. W. 803; *Masonic Temple Ass'n v. Channell*, 43 Minn. 353; 45 N. W. 716; *International Fair, etc. Ass'n v. Walker*, 83 Mich. 386; 47 N. W. 338; *Corwith v. Culver*, 69 Ill. 502; *Detroit Driving Club v. Fitzgerald*, 109

participation must be *qua* shareholder: it is not enough that the shareholder may have dealt with the company as any stranger might do.¹ The defence may be waived in advance by a stipulation in the subscription,² or the shareholder will be precluded from raising it if at the time he subscribed the company was already engaged in business.³ On the other hand, the payment of one call which was unauthorized because the capital had not been fully subscribed will not, it has been held, necessarily estop the shareholder from resisting on that ground subsequent calls;⁴ for the first payment may have been made without knowledge of the facts or in the belief that the money was needed for preliminary expenses.

§ 755. **Calls after Abandonment of Business by Company.** — The abandonment by the company of its enterprise or undertaking constitutes no defence to an action for calls.⁵ So, the sale of the entire undertaking and franchise of the company by way of foreclosure of a mortgage will not affect a shareholder's obligations.⁶ Perhaps the money may be needed to discharge obligations incurred prior to such abandonment. *A fortiori*, the abandonment of a part only of the undertaking will not exonerate a shareholder from payment for his shares.⁷

Mich. 670; 1 Morawetz on Priv. Corps., 2d ed., § 156.

But see *Oldtown, etc. R. R. Co. v. Veazie*, 39 Me. 571.

Cf. *New Hampshire Central R. R. v. Johnson*, 30 N. H. 390; 64 Am. Dec. 300 (where there was held to be no waiver by attending meetings of the corporation without assenting to the transaction of business).

¹ *Gettysburg Nat. Bank v. Brown*, 95 Md. 367; 52 Atl. 975.

² *Emmitt v. Springfield, etc. R. R. Co.*, 31 Oh. St. 23; *Sweeney v. Tenn., etc. R. R. Co.* (Tenn.), 100 S. W. 732 (where the defence was held to be precluded by a provision for payment of the subscription at definite times, so that no call need be made by the company before enforcing payment); *St. Charles Mfg. Co. v. Britton*, 2 Mo. App. 290; *Iowa, etc. R. R. Co. v. Perkins*, 28 Iowa 281 (agreement to pay as certain work of

construction by the company should progress).

Cf. *Anderson v. Railroad*, 91 Tenn. 44; 17 S. W. 803; *Lail v. Mt. Sterling Coal Road Co.*, 13 Bush (Ky.) 32.

³ *Musgrave v. Morrison*, 54 Md. 161.

⁴ *Somerset, etc. R. R. Co. v. Cushing*, 45 Me. 524, 533; *North Stafford Steel, etc. Co. v. Ward*, L. R. 3 Ex. 172 (headnote inadequate); *Garling v. Baecht*, 41 Md. 305, 326.

⁵ *Re Jennings*, 1 Ir. Ch. 236, 241; *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 294; *Armstrong v. Karshner*, 47 Oh. St. 276; 24 N. E. 897.

But see *South Georgia, etc. R. R. Co. v. Ayres*, 56 Ga. 230.

⁶ *Buffalo, etc. R. R. Co. v. Gifford*, 87 N. Y. 294; *Buffalo, etc. R. R. Co. v. Clark*, 22 Hun (N. Y.) 359.

Cf. *Armstrong v. Karshner*, 47 Oh. St. 276; 24 N. E. 897.

⁷ *Buffalo, etc. R. R. Co. v. Clark*, 22 Hun (N. Y.) 359.

§ 756. **Calls after Ultra Vires Acts — After Acceptance of Unconstitutional legislative Amendment to Charter.** — By parity of reasoning, excess of power by the corporation will not justify a dissenting shareholder in refusing to pay calls.¹ On the other hand, with apparent inconsistency, the courts have held that the acceptance of an unconstitutional legislative amendment to the charter by the majority of the shareholders will release the dissenting minority from any further liability,² unless some one or more of the minority choose to enjoin the corporation from acting under the amendment.³

§ 757. **Statutory and other Regulations as to Amount and Frequency of Calls.** — Not infrequently, by statute or by a company's regulations, some limit is placed on the amount which may be called in from the shareholders at any one time, and a minimum interval to elapse between calls is prescribed. If a call be made for more than the prescribed maximum, or if it be made too soon after a previous call, it is invalid and unenforceable.⁴ If an act of incorporation provides that at least two months shall elapse between calls, a call made within two months after another call is invalid even though the earlier call was itself invalid because made within two months of a still earlier call, unless the second call had been collected from none of the shareholders and had been formally declared void by the company.⁵ Regulations limiting the amount which may be assessed at any one time apply to the amount which is required to be paid at any one time, and do not, according to American decisions, invalidate successive calls voted at one time but payable separately.⁶ The contrary, however, was held by the House of

¹ *Cartwright v. Dickinson*, 88 2d ed., § 119-§ 120, 153; 2 Clark & Tenn. 476; 12 S. W. 1030; 17 Am. Marshall on Priv. Corps., § 482, St. Rep. 910; 7 L. R. A. 706; *Proprietors of City Hotel v. Dickinson*, 6 Gray (Mass.) 586; 1 Morawetz on Priv. Corps., 2d ed., § 115-§ 117; 2 Clark & Marshall on Priv. Corps., § 488. But cf. *Midland, etc. Ry. Co. v. Gordon*, 16 M. & W. 804. As to the effect of forfeiture of shares upon liability of the holder see infra, § 828.

But see *South Georgia, etc. R. R. Co. v. Ayres*, 56 Ga. 230.

² *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536.

³ *Ashton v. Burbank*, 2 Dillon 435; *Oldtown, etc. R. R. Co. v. Veazie*, 39 Me. 571; *Hartford, etc. R. Co. v. Croswell*, 5 Hill (N. Y.) 383; 1 Morawetz on Priv. Corps.,

⁴ Cf. *Re Jennings*, 1 Ir. Ch. 236. ⁵ *Welland Ry. Co. v. Berrie*, 6 H. & N. 416.

⁶ *Penobscot R. R. Co. v. Dummer*, 40 Me. 172; 63 Am. Dec. 654;

Lords.¹ But even according to this English doctrine, while the voting of the two calls simultaneously is irregular, the one payable first is valid.² Moreover, if the required interval elapse between the time when the resolution for the first call is made and the time when the resolution for the second call is made, as well as between the time fixed for payment of the first call and that fixed for payment of the second, both calls are valid; the court "cannot construe the time of the making of the call to be the time when the call is payable in the one case, and in the other case, the time when the resolution for the call is made."³ If the law prohibits the making of a call while a previous call remains unpaid unless an attempt has been made to enforce its collection, the off-setting of a fraudulent claim against the former call is not such payment as will authorize the second call.⁴

§ 758. **By whom Calls may be made** — By directors, by Shareholders, etc. — Where the statutes applicable to a company as well as its regulations are silent upon the question by whom calls shall be made, the power of levying them may be exercised by the directors.⁵ If the power be expressly conferred upon the directors or other agents, it cannot be delegated by them;⁶ but nevertheless a general meeting of the shareholders, the supreme corporate authority, might, it is submitted, take the matter into its own hands and call in unpaid capital.⁷ Where, however, by the express terms of the subscription it is payable on call by the directors, a call levied by a meeting of shareholders is ineffective.⁸

§ 759. **How Calls may be paid** — Cash — Set-off. — Calls are, in the absence of special agreement — a matter which is treated

Rutland, etc. R. R. Co. v. Thrall, 35 Vt. 536; *Penobscot, etc. R. R. Co. v. Dunn*, 39 Me. 587.

¹ *Baillie v. Edinburgh Oil Gas Light Co.*, 3 Cl. & Fin. 639; *Stratford, etc. Ry. Co. v. Stratton*, 2 B. & Ad. 518.

Cf. *Ambergate, etc. Ry. Co. v. Mitchell*, 6 Eng. Ry. Cas. 235.

² *Baillie v. Edinburgh Oil Gas Light Co.*, 3 Cl. & Fin. 639, 661.

³ *Ambergate, etc. Ry. Co. v. Mitchell*, 4 Exch. 540, 543.

⁴ *Strouse v. Sylvester*, 66 Pac. 660; 134 Cal. xx.

⁵ See *infra*, § 1435.

⁶ 1 Morawetz on Priv. Corps., 2d ed., § 145. Cf. *infra*, § 1467.

⁷ See *infra*, § 1191.

⁸ Cf. *Brockway v. Gadsden, etc.*

Land Co., 102 Ala. 620; 15 So. 431.

below — payable only in cash. They go to make up a fund — often called in America a “trust-fund” — for defraying the expenses and paying the debts of the company. If the requirement of payment in cash be rigorously enforced, a shareholder who may happen also to be a creditor of the company should not be permitted to set-off his liability for calls against that indebtedness.¹ Such is the law where the company is insolvent and has ceased to be a going concern, both in England² and America;³ and similarly the shareholder cannot deduct the amount of the unpaid calls from the indebtedness and prove against the company for the balance,⁴ nor can he prove for the full amount of the debt and set off the calls against the dividend payable to him on his claim.⁵ Hence, too, a shareholder cannot set off sums which he has paid upon void shares issued in excess of the company’s authorized capital against his liability for unpaid subscriptions to the lawful capital.⁶ In the United States the same rules apply where the company has been adjudicated a bankrupt, and that too although the bankrupt act expressly provides that set-off shall be allowed in all cases of mutual debts.⁷ In England that precise question cannot arise, since corporations are not within the British Bankrupt Acts. It is, however, held by the English courts, that where a shareholder becomes bankrupt, debts owing to him by the company may by

¹ So-called set-off by agreement with the company is really payment, and is valid. *Goodwin v. McGehee*, 15 Ala. 232, 249. See *infra*, § 794, § 797. As to crediting sums paid promoters, *Nash v. Rosenthal* (Cal.), 94 Pac. 850.

² *Black & Co.’s Case*, 8 Ch. 254; *Washington Diamond Co.* (1893), 3 Ch. 95; *Whitehouse & Co.*, 9 Ch. D. 595; *Hiram Maxim Lamp Co.* (1903), 1 Ch. 70 (where the company went into liquidation after plea of set-off but before judgment in an action by the company against the shareholder to recover the call).

But see *Clark’s Case*, 7 Eq. 550.

Cf. *Holden’s Case*, 8 Eq. 444 (where an attempt was made to pay calls with coupons cut from the company’s debentures); *Re G. E. B.* (1903), 2 K. B. 340.

³ *Sawyer v. Hoag*, 17 Wall. 610; *Bausman v. Kinnear*, 79 Fed. 172; 24 C. C. A. 473.

Cf. *Boulton Carbon Co. v. Mills*, 78 Iowa 460; 43 N. W. 290; 5 L. R. A. 649; *Hall v. U. S. Ins. Co.*, 5 Gill 484.

⁴ *Grissell’s Case*, 1 Ch. 528.

Cf. *Addison v. Pacific Coast Milling Co.*, 79 Fed. 459 (holding that a shareholder who is indebted to the company for unpaid subscriptions cannot in respect to a claim against the company for wages have the benefit of a statute making claims for wages preferred claims); *Somerset Nat. Banking Co. v. Adams*, 72 S. W. 1125; 24 Ky. Law Rep. 2083.

⁵ *Grissell’s Case*, 1 Ch. 528.

⁶ *Scovill v. Thayer*, 105 U. S. 143.

⁷ *Sawyer v. Hoag*, 17 Wall. 610.

virtue of the provision in the bankrupt law for set-off of mutual debts be set off against calls, whether the debt is less than the calls, so that the question arises in the bankruptcy proceeding,¹ or whether it is greater than the calls, so that the question must be decided in the winding-up of the company.² A shareholder who is also a creditor of the company may prove against it in liquidation proceedings *pari passu* with other creditors even though his shares are not fully paid-up, provided only all calls then due have been paid.³ The question whether set-off can be allowed against a shareholder's statutory liability to creditors is entirely distinct and is not here considered.⁴

§ 760. **Liability of Shareholders for Interest.** — As a shareholder is not in default until a call is made and the requisite notice given, it follows that interest should not begin to run against him until that time; and such is undoubtedly the law.⁵ On the other hand, upon the expiration of the prescribed period of notice, interest runs against the shareholders in default, according to some authorities in the discretion of the jury⁶ and according to others as a matter of right.⁷ So, where by the terms of a subscription to shares, payment is to be made in regular monthly instalments, the instalments should ordinarily carry interest from the time they respectively fall due.⁸ If a statute expressly enact that interest shall run on overdue calls, the interest will be recoverable whether the declaration contain

¹ *Re Duckworth*, 2 Ch. 578.
Cf. *Kingstown Yacht Club*, 21 L. R. Ir. 199; *Re G. E. B.* (1903), 2 K. B. 340.

² *Ex parte Strang*, 5 Ch. 492.

³ *Grissell's Case*, 1 Ch. 528.

⁴ As to this see *Cahill v. Original Big Gun, etc. Ass'n*, 94 Md. 353; 50 Atl. 1044; 89 Am. St. Rep. 434; 3 Clark & Marshall on Priv. Corps., § 827, and cases cited.

⁵ *Hambleton v. Glenn*, 72 Md. 331; 20 Atl. 115; *Jackson, etc. Ins. Co. v. Walle*, 105 La. 89; 29 So. 503. Cf. *Seattle Trust Co. v. Pitner*, 18 Wash. 401; 51 Pac. 1048 (holding that interest does not run on a note given in payment of a subscription to shares, even after maturity, where there was no express stipulation for

interest and no call for payment); *Johnson v. Lytle's Iron Agency*, 5 Ch. D. 687.

⁶ *Musgrave v. Morrison*, 54 Md. 161; *Frank v. Morrison*, 55 Md. 399.

⁷ *Hambleton v. Glenn*, 72 Md. 331; 20 Atl. 115 (as to law of Virginia); *North River Meadow v. Shrewsbury Church*, 22 N. J. Law 424; 53 Am. Dec. 258; *Gould v. Oneonta*, 71 N. Y. 298; *McCoy v. World's Columbian Exposition*, 186 Ill. 356; 57 N. E. 1043; 78 Am. St. Rep. 288. Cf. *Lackey v. Richmond, etc. R. Co.*, 17 B. Monr. (Ky.) 43.

Contra: *Frank v. Morrison*, 55 Md. 399. Cf. *American Pastoral Co. v. Gurney*, 61 Fed. 41.

⁸ *Hawkins v. Citizens' Real Estate, etc. Co.* (Oreg.), 64 Pac. 320.

a count for interest or not.¹ A provision in a company's regulations stipulating that overdue calls shall carry interest at a high rate applies only to calls made by the company while a going concern, and not to calls made by the liquidator or receiver in the winding-up.² In England interest is allowed on unpaid calls under the statute, 3 & 4 Will. 4, c. 42, § 28.³

§ 761. **Statute of Limitations as Defence.** — The statute of limitations begins to run when a call is made and notice given,⁴ but not before that time,⁵ except in a few states in which it runs from the date of the defendant's subscription.⁶ If by the terms of the subscription the shareholder agrees to pay at some fixed

¹ *Southampton Dock Co. v. Richards*, 1 Man. & Gr. 448.

As to statutes allowing interest by way of penalty for non-payment of calls, see further, *Lackey v. Richmond, etc. R. Co.*, 17 B. Monr. (Ky.) 43.

² *Welsh Flannel Co.*, 20 Eq. 360.

³ *Ex parte Lintott*, 4 Eq. 184; *Barrow's Case*, 3 Ch. 784; *Welsh Flannel Co.*, 20 Eq. 360.

But cf. *Stocken's Case*, 3 Ch. 412.

See also *Faure Electric, etc. Co. v. Phillipart*, 58 L. T. 525.

⁴ *Baltimore, etc. Turnpike Co. v. Barnes*, 6 H. & J. (Md.) 57; *Western R. R. Co. v. Avery*, 64 N. Car. 491.

Cf. *Morrison v. Savage*, 56 Md. 142.

⁵ *Glenn v. Williams*, 60 Md. 93; *Scovill v. Thayer*, 105 U. S. 143 (where the company had become a bankrupt); *Taggart v. Western Md. R. R. Co.*, 24 Md. 563, 597; 89 Am. Dec. 760; *Hawkins v. Glenn*, 131 U. S. 319; 9 Sup. Ct. 739; *Glenn v. Marbury*, 145 U. S. 499; 12 Sup. Ct. 914; *Moses v. Ocoee Bank*, 1 Lea (Tenn.) 398; *Curry v. Woodward*, 53 Ala. 371; *Vanderwerken v. Glenn*, 85 Va. 9; 6 S. E. 806; *Semple v. Glenn*, 91 Ala. 245; 6 So. 46; 9 So. 265; 24 Am. St. Rep. 894; *Glenn v. Howard*, 81 Ga. 383; 8 S. E. 636; 12 Am. St. Rep. 318; *Great Western Tel. Co. v. Gray*, 122 Ill. 630; 14 N. E. 214; *Glenn v. Macon*, 32

Fed. 7; *Glenn v. Liggett*, 135 U. S. 533; 10 Sup. Ct. 867; *Brockway v. Gadsden, etc. Land Co.*, 102 Ala. 620; 15 So. 431; *Union Savings Bank v. Leiter*, 145 Cal. 696; 79 Pac. 441; *Otter View Land Co.'s Receiver v. Bowling's Exrx.*, 70 S. W. 834; 24 Ky. Law Rep. 1157; *Cook v. Carpenter*, 61 Atl. 799; 212 Pa. 165; 108 Am. St. Rep. 854; *Haggert Bros. Mfg. Co.*, 19 Ont. App. 582.

Cf. *New England Fire Ins. Co. v. Haynes*, 71 Vt. 306; 45 Atl. 221; 76 Am. St. Rep. 771; *Union Savings Bank v. Leiter*, 145 Cal. 696, 709; 79 Pac. 441 (where a call was made and then rescinded, and a subsequent call made); *West v. Topeka Savings Bank*, 66 Kans. 524; 72 Pac. 252; 97 Am. St. Rep. 385; 63 L. R. A. 137; *Fitzgerald's Estate v. Union Sav. Bank*, 90 N. W. 994; 65 Nebr. 97.

⁶ *Great Western Tel. Co. v. Purdy*, 83 Iowa 430; 50 N. W. 45 (affirmed, in so far as federal questions were decided, in 162 U. S. 329; 16 Sup. Ct. 810); *Harris v. Gateway Land Co.*, 29 So. 611; 128 Ala. 652.

Cf. *Pittsburgh, etc. R. R. Co. v. Plummer*, 37 Pa. St. 413; *Chilberg v. Siebenbaum*, 41 Wash. 663; 84 Pac. 598 (holding that against the derivative right of creditors the statute begins to run upon the declared or notorious insolvency of the corporation).

time or times, then, as stated above, there is no necessity for a call, and consequently the statute of limitations begins to run as soon as, by the terms of the subscription, payment becomes due.¹ The period applicable would seem to be that which governs actions on simple contract; but in an English case, the court held that the claim was founded upon a statute, the incorporation act, which is deemed a specialty, and that accordingly the action would not be barred until the lapse of the period applicable to actions on specialties.² An Alabama case holds that after the lapse of twenty years the subscription will be presumed to have been paid, although no call had been made, so that the statute of limitations would not be a bar;³ but it would seem that the same reasons which prevent limitations from running should also prevent the rise of any presumption of payment from mere lapse of time. The fact that the remedy of the corporation against a shareholder is barred by limitations does not have the same effect as actual payment, and hence the shareholder in such a case has no right to a certificate stating the shares to be paid-up.⁴

§ 762-§ 773. *Who are subject to the Liability.*

§ 762. **Actual Shareholders as distinguished from mere Subscribers.** — The liability incident to the status of shareholder attaches to those persons, and those only, who have actually attained that status.⁵ What is necessary and what is not necessary in order to constitute a person a shareholder has been already considered, and need not be repeated.⁶ When a subscriber attains the status of a shareholder, he becomes subject to the liabilities of a shareholder. For example, as the issue of a share-certificate is not necessary in order to make a man a shareholder, it follows that he may be held for calls without proof of the issue or even of the readiness to issue the same.⁷

¹ *Williams v. Matthews*, 103 Va. 180; 48 S. E. 861; *Williams v. Taylor*, 99 Md. 306; 57 Atl. 641.

² *Cork, etc. Ry. Co. v. Goode*, 13 C. B. 826.

³ *Semple v. Glenn*, 91 Ala. 245; 6 So. 46; 9 So. 265; 24 Am. St. Rep. 894.

⁴ *Johnson v. Albany, etc. R. R. Co.*, 54 N. Y. 416.

⁵ *New Brunswick, etc. Ry. Co. v. Muggeridge*, 4 H. & N. 580. See *infra*, § 778.

⁶ *Supra*, § 170 et seq.

⁷ *Hawley v. Upton*, 102 U. S. 314. Cf. *supra*, § 171.

§ 763. **Owners of Shares at Time of Call liable.** — As between successive owners of shares, by transfer and so forth, the liability to pay calls attaches to the person who holds the shares when the call is made. The date when the call is payable is not material; the crucial point is the date of the making of the call.¹ *Prima facie*, this means the date of the passage of the resolution making the call; but as we have seen a resolution may be passed that a call be made at some fixed date in the future, and in such a case the liability attaches to the person who holds the shares at the date so fixed.

§ 764. **Criterion of Ownership of Shares for this Purpose.** — For the purposes of this rule, the ownership of the shares must in general be determined by the company's share register or stock-book.² One of the most important reasons for requiring the company to keep a register of its members is to enable it to know who may be held liable as shareholders at any given time. Hence, the register must serve this function. If, however, the register is erroneous through the company's own fault, the person whose name is improperly registered will be exempted from liability, and the person whose name ought to have been registered will be liable in his stead.³ It is often thought that the liability of a person whose name is registered as shareholder while the entire beneficial interest is in another must rest upon

¹ *Campbell v. American Alkali Co.*, 125 Fed. 207; 113 Fed. 398; 61 C. C. A. 317.

² *Giesen v. London, etc. Mfg. Co.*, 102 Fed. 584; 42 C. C. A. 515; *Russell v. Easterbrook*, 71 Conn. 50; 40 Atl. 905; *Visalia, etc. R. R. Co. v. Hyde*, 110 Cal. 632; 43 Pac. 10; 52 Am. St. Rep. 136; *Plumb v. Bank of Enterprise*, 48 Kans. 484; 29 Kans. 699; *Worrall v. Judson*, 5 Barb. 210; *Johnson v. Somerville Dyeing, etc. Co.*, 15 Gray (Mass.) 216; *Brown v. Morton*, 58 Atl. 94; 71 N. J. Law 26; *Hurlburt v. Arthur*, 140 Cal. 103; 73 Pac. 734; 98 Am. St. Rep. 17; *White v. Commercial, etc. Bank*, 66 S. Car. 491; 45 S. E. 94; 97 Am. St. Rep. 803; *Sherwood v. Illinois Trust, etc. Co.*, 195 Ill. 112; 62 N. E. 835; 88 Am. St. Rep. 183; *Cook v. Carpenter* (Pa.),

61 Atl. 804; 212 Pa. 177; *People's Home Sav. Bank v. Stadtmuller* (Cal.), 88 Pac. 280 (where a statute expressly enacted that an unregistered transfer should not be valid except as between the parties).

But see *Cutting v. Damarel*, 88 N. Y. 410; *Dain Mfg. Co. v. Trumbull Seed Co.*, 95 Mo. App. 144; 68 S. W. 951; *Vale Mills v. Spalding*, 62 N. H. 605.

³ *Hunt v. Seeger*, 98 N. W. 91; 91 Minn. 264; *Earle v. Carson*, 188 U. S. 42; 23 Sup. Ct. 254 (as to statutory liability under National Banking Act); *Hayes v. Shoemaker*, 39 Fed. 319 (same point as last case); *Bracken v. Nicol* (Ky.), 99 S. W. 920; *Smith v. Bank of Nova Scotia*, 8 Can. Sup. Ct. 558; *Alston's Case*, 22 Vict. L. R. 243 n.

See *infra*, § 861.

estoppel; but if the theory of the legal title to shares which is advocated below is correct, the liability of the registered shareholder rests rather on the fact that he is the holder of the legal title. In order that the registered owner be held liable, the doctrine of estoppel need be resorted to only when by statute a trustee of shares is exempted from liability.¹ The cases which deal with the question whether the registered holder or the "true owner" is the person subject to the statutory liability to creditors² depend perhaps upon somewhat different considerations, and are not treated here.

§ 765. **Effect of Transfer of Shares upon Liability.** — It follows that a transfer of shares completed by a proper entry in the company's books releases the transferor from all liability for subsequent calls.³ This is true although the transferor was the original allottee,⁴ his case not being assimilated to that of an original lessee of land, whose liability persists in spite of an assignment of the term. Probably, a transfer would release the original allottee from future liability even though he might have expressly promised at the time of subscribing to the shares to pay their par value.⁵ A transfer works a complete novation, so that the transferee may be sued in assumpsit for any calls made after the transfer, although he may have made no express promise to pay the same;⁶ and a declaration or complaint charging the defendant as subscriber to shares has been held to be sustained by proof that the defendant acquired shares by transfer.⁷

¹ See *infra*, § 769.

² E. g. *Ohio Valley Nat. Bank v. Hulitt*, 204 U. S. 162; *White v. Marquardt*, 105 Iowa 145; 74 N. W. 930. As to liability under the National Bank Act, see also *infra*, p. 621, n. 3, and p. 622, n. 2.

³ *Brinkley v. Hambleton*, 67 Md. 169, 176; 8 Atl. 904 (semble).

⁴ *Huddersfield Canal Co. v. Buckley*, 7 T. R. 36; *Rochester, etc. Land Co. v. Raymond*, 158 N. Y. 576; 53 N. E. 507; 47 L. R. A. 246; *Stewart v. Walla Walla, etc. Pub. Co.*, 1 Wash. St. 521; 20 Pac. 605; *Finletter v. Acetylene Light Co.*, 215 Pa. 86; 64 Atl. 429.

Contra in Nebraska by virtue of a provision in the state constitution.

Commercial Nat. Bank v. Gibson, 37 Nebr. 750, 764-765; 56 N. W. 616.

Cf. *Aultman's Appeal*, 98 Pa. St. 505 (semble). See also *infra*, § 766.

⁵ But see *Schenectady, etc. Co. v. Thatcher*, 11 N. Y. 102, 108.

⁶ *Webster v. Upton*, 91 U. S. 65; *Visalia, etc. R. R. Co. v. Hyde*, 110 Cal. 632; 43 Pac. 10; 53 Am. St. Rep. 136; *Bend v. Susquehanna Bridge Co.*, 6 H. & J. (Md.) 128; 14 Am. Dec. 261; *Sigua Iron Co. v. Brown*, 171 N. Y. 488; 64 N. E. 194.

Cf. *Bell's Appeal*, 115 Pa. St. 88; 8 Atl. 177; 2 Am. St. Rep. 532 (reviewing earlier Pennsylvania cases); *Reid v. Dejarnette*, 123 Ga. 787; 51 S. E. 770.

⁷ *Glenn v. Porter*, 73 Fed. 275; 19 C. C. A. 503.

As intimated above,¹ however, the transferor and not the transferee is liable for any calls that were made prior to the transfer,² even though payable afterwards.³ The transferor is not, however, relieved from liability for future calls, whether the transfer be absolute or security for a debt, until the transfer is registered,⁴ unless the failure to register is occasioned by the company's own wrongful refusal.⁵ Accordingly the transferor remains liable when the transfer books were lawfully closed when the transfer was presented for registration, and the company became insolvent before the transfer could be registered.⁶ If the transferor promise the transferee to pay future calls, the question whether the company can sue upon that promise depends upon the law of the *lex fori* as to the right of a stranger to sue upon a contract performance of which would inure in part to his benefit.⁷

In order that the transfer should relieve the transferor from future liability, the only requirement in England is that the transfer be absolute, the transferor retaining no interest in the shares.⁸ The American law, on the other hand, refuses to relieve the transferor from liability where the assignment was made with knowledge of the company's failing condition and for the purpose of escaping liability and where the transferee is insolvent.⁹ Even in America, a creditor who has acquired

¹ Supra, § 763.

² *Visalia, etc. R. R. Co. v. Hyde*, 110 Cal. 632; 43 Pac. 10; 52 Am. St. Rep. 136.

³ *Campbell v. American Alkali Co.*, 125 Fed. 207; 61 C. C. A. 317.

⁴ *Plumb v. Bank of Enterprise*, 48 Kans. 484; 29 Pac. 699; *McDonald v. Dewey*, 134 Fed. 528; 67 C. C. A. 408; *Kenyon v. Fowler*, 155 Fed. 107, 109; *Knickerbocker Trust Co. v. Myers*, 133 Fed. 764 (affirmed in 139 Fed. 111). See also cases cited supra, § 764.

⁵ See supra, § 764, and infra, § 861.

⁶ *Cook v. Carpenter*, 61 Atl. 804; 212 Pa. 177.

⁷ See *Crown Slate Co. v. Allen*, 48 Atl. Rep. 968; 199 Pa. 239. But cf. *Discoverers Finance Corp.* (1908), 1 Ch. 141.

⁸ 2 Lindley on Companies, 6th

ed., 1122-1124. Cf. *Nat. Bank v. Case*, 99 U. S. 628. But see *Discoverers' Finance Corp.* (1908), 1 Ch. 141 (holding that the fact of the transfer being "out and out" is not conclusive against the transferor's continuing liability).

Cases where the transfer is merely colorable, the transferor retaining the beneficial ownership, constitute an exception to the rule that the trustee and not the *cestui que trust* of shares is liable in respect thereof. See *King's Case*, 6 Ch. 196; *Massey & Griffin's Case* (1907), 1 Ch. 582. Cf. *Cox's Case*, 33 L. J. Ch. 145 (where the trust was created in order to "bull" the company's shares in the market).

⁹ *Aultman's Appeal*, 98 Pa. St. 505; *Burt v. Real Est. Exch.*, 175 Pa. St. 619; 34 Atl. 923; 52 Am. St. Rep. 858; *Bowden v. Johnson*, 107

shares as security for a debt is relieved from any future liability by a transfer in exercise of a power of sale contained in the contract of hypothecation, although the sale was made for a nominal consideration and although his only motive in making it was to escape liability as shareholder.¹ Even if a transfer be colorable merely, so that the company might continue to hold the transferor liable as shareholder, yet if it registers the transfer and sues the transferee to collect a call, it cannot thereafter change front and sue the transferor.² Although perhaps a transfer from the insolvent transferee to a solvent person would relieve the first transferor from further liability, yet the burden is upon the latter to establish the defence by proving the solvency of the second transferee.³ A transfer to a fictitious transferee will, of course, leave the transferor liable.⁴

If the transfer is made to a *bona fide* purchaser without notice that the shares are not paid-up, the purchaser, as will presently be shown, incurs no liability,⁵ and therefore necessarily the vendor remains liable for any sum which the company is thus prevented from collecting from the purchaser.⁶

U. S. 251; 2 Sup. Ct. 246; *Rider v. Morrison*, 54 Md. 429, 444 (headnote inadequate); *People's Home Savings Bank v. Rickard*, 139 Cal. 285; 73 Pac. 858; *Stuart v. Hayden*, 169 U. S. 1; 18 Sup. Ct. 274 (distinguished in *Earle v. Carson*, 188 U. S. 42; 23 Sup. Ct. 254); *Gottschalk v. Stover*, 85 Mo. App. 566; *Lamson v. Hutchings*, 118 Fed. 321 (transferor liable at law and not merely in equity); *Baker v. Reeves*, 85 Fed. 837 (both transferor and transferee liable); *McDonald v. Dewey*, 202 U. S. 510; 26 Sup. Ct. 731 (burden of proving solvency of transferee on defendant); *Earle v. Carson*, 188 U. S. 42; 23 Sup. Ct. 254; *Central Agricultural, etc. Ass'n v. Gold Life Ins. Co.*, 70 Ala. 120 (burden of proving solvency of transferee on transferor). *Anglo-American Land, etc. Co. v. Lombard*, 132 Fed. 721, 738-739 (transfer of all the shares together with all the assets of the company to another corporation); *McDonald v. Dewey*, 202 U. S. 510;

26 Sup. Ct. 731 (as to whether the transferor can be held liable for the benefit of subsequent creditors).

Cf. *McConey v. Belton Oil, etc. Co.*, 97 Minn. 190; 106 N. W. 900 (holding that if transfer proved to have been made without consideration and when company was insolvent, "fraudulent" intent to escape liability is presumed).

¹ *Magruder v. Colston*, 44 Md. 349; 22 Am. Rep. 47.

² *Rochester, etc. Land Co. v. Raymond*, 158 N. Y. 576; 53 N. E. 507; 47 L. R. A. 246.

But see *People's Home Savings Bank v. Rickard*, 139 Cal. 285; 73 Pac. 858 (where the company was insolvent).

³ *People's Home Savings Bank v. Rickard*, 139 Cal. 285; 73 Pac. 858.

⁴ *Muskingum Valley, etc. Co. v. Ward*, 13 Oh. 120; 42 Am. Dec. 191. Cf. *infra*, § 879.

⁵ *Infra*, § 800.

⁶ *McBryan v. Universal Elevator*

A transferee of shares, who is duly registered, cannot escape liability for calls by showing that he was induced to purchase the shares by the fraud of the transferor, even though the transferor was an officer of the company.¹

§ 766. **Statutes making former Shareholders liable notwithstanding Transfer.** — Statutes sometimes provide that past members of a corporation shall continue liable for calls for some time after the transfer.² In such cases, the transferor is a *quasi* surety for the transferee, and if he is called upon to pay has a right to compel the transferee, or whoever holds the shares at the time of the call, to reimburse him.³

§ 767. **Liability in respect of Shares held in Trust, etc. — Liability of Holder of Legal Title.** — The liability ordinarily, and in the absence of statute, attaches to the holder of the legal title to the shares. For example, where shares are held in trust, the trustee and not the *cestui que trust* is liable; ⁴ but he has of course a right to be indemnified by the trust estate,⁵ or if the benefi-

Co., 89 N. W. 683; 130 Mich. 111; 97 Am. St. Rep. 453.

Contra: *Warton Beet Sugar Co.*, 12 Ont. L. R. 149.

¹ *Hart v. Globe Ins. Co.*, 113 Fed. 307.

Cf. *Stufflebeam v. DeLashmutt*, 83 Fed. 449. See also *infra*, § 963.

² See *Sprague v. National Bank of America*, 172 Ill. 149; 50 N. E. 19; 64 Am. St. Rep. 17; 42 L. R. A. 606; *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146.

³ *Infra*, § 972.

⁴ *Mitchell's Case*, 9 Eq. 363; *Williams' Case*, 1 Ch. D. 576 (headnote inadequate); *Ex parte Bugg*, 2 Drewry & Sm. 452; *Hawkins v. Glenn*, 131 U. S. 319; 9 Sup. Ct. 739; *Pullman v. Upton*, 96 U. S. 328, 330; *McKim v. Glenn*, 66 Md. 479; 8 Atl. 130; *Hampton v. Foster*, 127 Fed. 468; *Union Savings Bank v. Willard* (Cal.), 88 Pac. 1098; *Kerr v. Urie*, 86 Md. 72; 37 Atl. 789; 63 Am. St. Rep. 493; 38 L. R. A. 119 (where the *cestui que trust* was an infant).

But see *Ulster Ry. Co. v. Bainbridge*, Ir. Rep. 2 Eq. 190; *Lloyd v.*

Preston, 146 U. S. 630, 644-645; 13 Sup. Ct. 131 (arising under an Ohio statute enacting that *cestuis que trust* of stock should be deemed stockholders).

Cf. *Preston v. Grand Collier Dock Co.*, 11 Sim. 327 (where the *cestui que trust* was the company itself); *Colonial Investment & Agency Co.*, 19 Vict. L. R. 381 (where the *cestui que trust* was the company itself and where the argument that the company itself had paid for the shares in full did not prevail); *Winston v. Dorsett, etc. Co.*, 129 Ill. 64; 21 N. E. 514; 4 L. R. A. 507 (where the shares were held in trust for the other shareholders); *Andrews v. Nat. Foundry, etc. Works*, 76 Fed. 166; 22 C. C. A. 110; 77 Fed. 774; 23 C. C. A. 454 (where the shares were held by a mortgagee from the company). As to cases where the corporation is the *cestui que trust*, see further, *supra*, § 202.

⁵ *Mitchell's Case*, 9 Eq. 363 (semble); *Morse v. Pacific Ry. Co.*, 93 Ill. App. 33, 37 (semble).

ciary be *sui juris* by the *cestui que trust* personally.¹ If the name of the trustee and not that of the *cestui que trust* appears on the company's books, the former is liable under the doctrine which has been mentioned above, that ordinarily the registered shareholder should be liable; but if the shares are registered in the name of "A, trustee for B," then A's liability can rest only upon the ground that the trustee, or holder of the legal title, is the person who is subject to the burdens of ownership.² The rule that the trustee and not the beneficiary is liable as shareholder applies even where the trust is created by the *cestui que trust* for the purpose of avoiding liability,³ unless indeed the *cestui que trust* has already become the legal owner of the shares, or at any rate has agreed with the company to take them, before they are put in the name of his nominee or trustee.⁴ The rule exempting the *cestui que trust* from direct personal liability to the company has been applied where the trustee or nominee was an infant.⁵ But where shares are registered in the name of a married woman who was incapable of contracting and signed the application at her father's instance and in ignorance of its effect, the court held that the daughter was not a trustee for the father, but that her name was a mere *alias* for his, just as if a fictitious name had been used, so that he was liable as shareholder.⁶ A person to whom shares are transferred as security for a debt and who is registered as share-

¹ *Hardoon v. Belilos* (1901), 33 C. C. A. 574; *Ohio Valley Nat. Bank v. Hulitt*, 204 U. S. 162 — may

² *Union Sav. Bank v. Willard* (Cal.), 88 Pac. 1098.

³ *King's Case*, 6 Ch. 196 (semble); *Higgins v. Fidelity Ins., etc. Co.*, 108 Fed. 475; 46 C. C. A. 509 (where a pledgee of shares had them registered in the name of an employee rather than in his own); *Hayes v. Fidelity Ins., etc. Co.*, 105 Fed. 160.

The cases holding that the "real owner" of shares in a national bank may always be liable as shareholder, — e. g. *American Alkali Co. v. Kurtz*, 134 Fed. 663; *Dunn v. Howe*, 107 Fed. 849; 47 C. C. A. 13 (holding that both the registered holder and the "real owner" may be liable); *Houghton v. Hubbell*, 91 Fed. 453;

33 C. C. A. 574; *Ohio Valley Nat. Bank v. Hulitt*, 204 U. S. 162 — may be supported on the ground that the National Banking Act expressly provides that trustees shall not be personally liable, but that the trust estate shall be liable instead.

⁴ See *supra*, § 765.

⁵ *Massey & Griffin's Case* (1907), 1 Ch. 582. But see *Victorian Mtge., etc. Bank v. Australian Financial, etc. Co.*, 19 Vict. L. R. 680 (where the *cestui que trust* had procured the company's assent to the transfer by a fraudulent representation that the infant had paid value for the shares).

⁶ *Pugh and Sharsman's Case*, 13 Eq. 566.

Cf. *Hulitt v. Ohio Valley Nat. Bank*, 137 Fed. 461; 69 C. C. A. 609.

holder is liable in respect of the shares.¹ Even if the shares were registered in his name expressly as pledgee, it would seem that he might well be deemed the holder of the legal title and therefore liable.²

§ 768. **Liability of Executor or Administrator.** — Even an executor who applies for shares *qua* executor is liable personally in respect thereof,³ with, however, the same right of indemnity as a trustee. Upon a shareholder's death, although the title to the shares devolves upon his executor, yet the latter is liable for calls made before or after the testator's death, not individually, but in his representative capacity,⁴ unless the shares are with his consent registered in his name.⁵ The liabilities of an executor or administrator of a deceased shareholder are considered at length below.⁶

§ 769. **American Statutes exempting Trustees, Executors, Pledgees, etc., from personal Liability.** — In the United States, statutes are frequently found which enact that a trustee, executor, or pledgee of shares shall not be liable in respect thereof, but that the *cestui que trust*, the estate of the testator, or the pledgor, shall be liable instead.⁷ The United States Supreme Court has held that such a statute exempts from liability one who has accepted shares of stock as collateral security for a debt of the company,⁸ and that the exemption may be claimed although the certificates of stock and the entries on the company's books do not disclose the fact that the shares are not held in his own right by the apparent owner,⁹ and although the registered holder

¹ *Tuthill Spring Co. v. Smith*, 90 Iowa 331; 57 N. W. 853; *Bend v. Susquehanna Bridge Co.*, 6 H. & J. (Md.) 128; 14 Am. Dec. 261; *Pullman v. Upton*, 96 U. S. 328; *People's Home Savings Bank v. Rauer* (Cal.), 84 Pac. 329.

² But see *Pauly v. State Loan, etc. Co.*, 165 U. S. 606; 17 Sup. Ct. 465. This case arising under the National Banking Act, there was a dilemma: if the creditor was invested with legal title to the hypothecated shares, he was a trustee, and as such exempted from liability by the express terms of the statute; and if he was not the holder of the legal title, he was exempted because he was not a shareholder.

³ *Leeds Banking Co.*, 1 Ch. 231.

⁴ *Houldsworth v. Evans*, L. R. 3 H. L. 263; *Baird's Case*, 5 Ch. 725. See also *infra*, § 976.

⁵ *Buchan's Case*, 4 A. C. 549.

⁶ *Infra*, § 976 et seq.

⁷ In addition to cases cited below, see *Fowler v. Gowing*, 152 Fed. 801; *Lucas v. Coe*, 86 Fed. 972; *Sayles v. Bates*, 15 R. I. 342, 345 (headnote inadequate); 5 Atl. 497 (as to a suit against the trustee in order to reach the assets of the trust estate). And see *supra*, p. 621 n. 3.

⁸ *Burgess v. Seligman*, 107 U. S. 20; 2 Sup. Ct. 10.

⁹ *Burgess v. Seligman*, 107 U. S. 20; 2 Sup. Ct. 10; *McMahon v. Macy*, 51 N. Y. 155; *Colonial Trust*

may have voted on the shares.¹ Other courts, however, have held that the statute is no protection unless the company's books disclose the fact that the shares were held in a fiduciary capacity.²

§ 770. **Infant Shareholders.** — The right of an infant who has subscribed to the shares of a corporation to repudiate the contract, disown the shares, and escape liability, has already been considered.³ So, too, the status of an infant transferee of shares is considered below.⁴ Inasmuch as the obligation to pay for shares attaches to the ownership thereof, it follows that an infant who has become the owner of shares not by virtue of contract, but by will or by devolution of law, may be liable as shareholder unless he disown the shares.⁵

§ 771. **Effect of Bankruptcy of Shareholder.** — If any of the shareholders becomes bankrupt, the company may prove against his estate for any calls that were overdue at the time of the bankruptcy.⁶ If, however, the company has a lien on the shares for overdue calls, it must either deduct from its claim the market value of the shares and prove merely for the balance, or else it must surrender its lien for the general benefit of all creditors.⁷ Under bankrupt laws which permit proof for contingent claims, a corporation cannot prove in respect of its potential claim for future calls, estimated according to the probabilities of calls being made;⁸ but where the statute provides for proof

Co. v. McMillan, 188 Mo. 547; 87 S. W. 933; 107 Am. St. Rep. 335.

Cf. *May v. Genesee County Savings Bank*, 120 Mich. 330; 79 N. W. 630.

¹ *Burgess v. Seligman*, 107 U. S. 20; 2 Sup. Ct. 10.

² *Hurlburt v. Arthur*, 140 Cal. 103; 73 Pac. 734; 98 Am. St. Rep. 17; *Sherwood v. Illinois Trust, etc. Co.*, 195 Ill. 112; 62 N. E. 835; 88 Am. St. Rep. 183; *Morse v. Pacific Ry. Co.*, 93 Ill. App. 33; *Adams v. Clark* (Colo.), 85 Pac. 642 (a well considered case). Compare the cases in which the United States Supreme Court has declared that a person who is registered as shareholder in a national bank is liable by estoppel although the National Banking Act expressly exempts trustees from

liability. *Nat. Bank v. Case*, 99 U. S. 628, 631; *Pauly v. State Loan & Trust Co.*, 165 U. S. 606; 17 Sup. Ct. 465 (semble).

³ *Supra*, § 198.

⁴ *Infra*, § 877.

⁵ *Leeds, etc. Ry. Co. v Fearnley*, 4 Ex. 26, 31 (semble).

⁶ *Re McMahon* (1900), 1 Ch. 173; *Glenn v. Howard*, 65 Md. 40, 58; 3 Atl. 895.

⁷ *Re Jennings*, 1 Ir. Ch. 236, 243-244.

⁸ *Glenn v. Howard*, 65 Md. 40; 3 Atl. 895; *Sayre v. Glenn*, 87 Ala. 631; 6 So. 45; *Furdonjee's Case*, 3 Ch. D. 264.

Under some insolvent laws the corporation's potential claim is discharged by the release, although not

for any liability or possibility of an obligation to pay money or money's worth, the potential claim for future calls has been held to be provable.¹ In consequence of such proof, however, the shares do not become fully paid shares, although the bankrupt is discharged from all personal liability in respect of them; and consequently the assignee cannot receive any dividends in the liquidation or winding-up of the company without first paying the amount which after receipt by the company of the dividend from the bankrupt's estate still remains unpaid on the shares.² The assignee or trustee in bankruptcy is at liberty to refuse to accept the shares if he deems the ownership of them too onerous;³ and if he do so, neither he nor the assets in his hands will be, it seems, subject to any individual liability for debts of the company imposed by statute upon shareholders.⁴

§ 772. **Holder of less than minimum or more than maximum Number of Shares allowed to one Person.** — A provision in a company's regulations that no person shall be allowed to hold less than a certain number of shares will not have the effect of exonerating from liability a person who holds less than such minimum;⁵ and similarly a provision that no person shall hold more than a certain number of shares will not relieve from liability a person who holds more than the maximum.⁶

§ 773. **Holder of Shares issued without Authority of Law or Irregularly.** — The question is often raised whether ownership of shares issued without authority of law or irregularly will

provable. See *Glenn v. Clabaugh*, 65 Md. 65, 67; 3 Atl. 902 (semble).

In one case the liability for uncalled subscriptions to capital was deemed to be a present debt *solvendum in futuro*, and as such provable against the bankrupt estate. *Glenn v. Abell*, 39 Fed. 10.

Cf. *Carey v. Mayer*, 79 Fed. 926; 25 C. C. A. 239; *South Staffordshire Ry. Co. v. Burnside*, 5 Ex. 129.

¹ *Re McMahon* (1900), 1 Ch. 173.

For a clear analysis of the English cases, which are somewhat confusing, see 1 Lindley on Companies, 6th ed., pp. 752-754.

² *Rowe's Trustee's Claim* (1906), 1 Ch. 1.

But see *Re McMahon* (1900), 1

Ch. 173 (where the contrary proposition was assumed by counsel and court).

³ *Sayre v. Glenn*, 87 Ala. 631; 6 So. 45; *Glenn v. Howard*, 65 Md. 40; 3 Atl. 895.

Cf. *Re Hooley* (1899), 2 Q. B. 579; *South Staffordshire Ry. Co. v. Burnside*, 5 Ex. 129. See also *infra*, § 983.

⁴ *American File Co. v. Garrett*, 110 U. S. 288; 4 Sup. Ct. 90.

But see *Graham v. Platt*, 65 Pac. 30; 28 Colo. 421.

⁵ *Leeds Banking Co.*, 1 Ch. 231.

⁶ *Hagerman v. Ohio Bldg., etc. Ass'n*, 25 Oh. St. 186 (leaving the question open as to the effect of a similar provision in a statute).

subject the holder to the liabilities incident to ownership of shares of stock. This question is discussed in connection with the subject of illegal or irregular increases of capital.¹

§ 774-§ 799. *SPECIAL AGREEMENTS VARYING NORMAL LIABILITY—SUBSCRIPTIONS ON SPECIAL TERMS.*

§ 774. *In general — Validity.* — We have given above a brief statement or description of the liability which normally, if not most frequently, attaches to the holder of shares in a corporation; we must now consider how far the nature or extent of that liability may be varied by agreement between the company and the shareholder. The general rule is that subscriptions on special terms — that is to say, subscriptions on terms which do not involve an obligation to pay the amount of the shares in cash as and when called for by the company — are quite permissible.² For example, a company may stipulate with some applicants for shares for the payment of a deposit on application or allotment although no such payment is exacted of other subscribers;³ or a shareholder may promise to pay his subscription at a fixed date without any call or notice.⁴ Likewise, the company may exact from the subscriber a waiver of the general rule of American law that calls cannot be made until the entire authorized capital has been subscribed,⁵ or may insist upon a stipulation dispensing with statutory formalities as to calls and assessments.⁶ So, the

¹ See *supra*, § 579, § 592.

² See *supra*, § 228.

It is submitted that even where a statute expressly lays down the rule that subscriptions to shares shall be payable on call, yet special contracts providing for payment in a different way should not be deemed prohibited. But see *Thigpen v. Mississippi Central R. R. Co.*, 32 Miss. 347.

As to the result of an unauthorized attempt of an agent to make special terms as to the mode of payment, see *Nippenose Mfg. Co. v. Staddon*, 68 Pa. St. 256.

³ *Alexander v. Automatic Telephone Co.* (1900), 2 Ch. 56.

A call, properly speaking, cannot

be made until shares are issued, differing in this respect from a deposit payable on application or allotment. *Croskey v. Bank of Wales*, 4 Giff. 314, 330-331.

⁴ *Northwood Union Shoe Co. v. Pray*, 67 N. H. 435; 32 Atl. 770; *Ruse v. Bromberg*, 88 Ala. 619; 7 So. 384.

Cf. *California, etc. Co. v. Callender*, 94 Cal. 120; 29 Pac. 859; 28 Am. St. Rep. 99; *Bohrer v. Adair*, 61 Nebr. 824; 86 N. W. 495.

⁵ *Emmitt v. Springfield, etc. R. R. Co.*, 31 Oh. St. 23. See *supra*, § 754.

⁶ *People's Home Sav. Bank v. Sadler* (Cal.), 81 Pac. 1029, 1032 (headnote inadequate).

corporation may receive payment in advance of calls, and may agree to pay interest on the sums so advanced.¹ So, also, where shares have been issued subject to payment in a particular manner, the company may agree to accept payment in any other mode that it may deem advisable.²

§ 775. **Issue of Shares at a Premium.** — A peculiar form of subscription on special terms is exhibited by the issue of shares at a premium — that is to say, for more than their par value.³ This is an expedient often resorted to in the organization of banks and trust companies and other corporations upon whose shareholders there rests some additional statutory liability regulated as to its amount by the par value of the shares held by them respectively. In such cases, for the purpose of diminishing the extent of the statutory liability, all persons who subscribe to shares are often required to take them at a premium, thus raising a working capital in excess of the nominal capital of the company. Although in this way the statute which imposes the liability is to a certain degree evaded, it seems that the validity of the practice has never been challenged on that score. The amount of the premium so voluntarily paid by the shareholder cannot be claimed as a credit in an action to enforce his liability upon his unpaid subscription to the capital,⁴ and certainly cannot be recovered either from the company or the other shareholders.⁵

§ 776. **Special Agreements amounting to complete or partial Release from Liability to pay par Value — Issue at a Discount.** — But while special terms inserted in subscriptions may affect the time or manner of payment, yet they should not amount to a virtual release from payment, in whole or in part. If a subscriber accepts shares upon the faith of the company's agreement that he shall not be called on to pay anything, or at any rate not the whole of their nominal amount, the stipulation is certainly not

¹ *Lock v. Queensland, etc. Co. v. Matabele, etc. Co.* (1901), 2 Ch. (1896), A. C. 461; *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536.

See also *infra*, § 1340.

² See *New Albany v. Burke*, 11 Wall. 96.

³ As to whether shares can lawfully be issued at par when the market price is higher, see *Hilder v. Dexter* (1902), A. C. 474; *Burrows*

As to the effect of issue of shares at a premium and as to the rights of holders of such shares, see *supra*, § 522.

⁴ *Musgrave v. Morrison*, 54 Md. 161.

⁵ *Esgen v. Smith*, 84 N. W. 954; 113 Iowa 25.

countenanced by the law.¹ In England, in such a case, the attempt to relieve from payment is quite nugatory, and the shareholder may be compelled either by the corporation or its liquidator to pay in full the par value of the shares.² This liability exists although the company may be perfectly solvent, so that creditors could not possibly be injured by the arrangement, and although payment is sought to be enforced for the benefit of other shareholders³ who perhaps had themselves approved or even participated in the arrangement, or who held their shares by assignment from persons who had approved or participated therein.⁴

In the United States, on the other hand, such agreements for the issue of shares at a discount are by the weight of authority valid so far as the rights of the assenting shareholders *inter sese* are concerned,⁵ or even as against prior creditors,⁶ or subsequent

¹ As to construing a contract of subscription, if possible, so as not to provide for an issue for less than par, see *Tulare Sav. Bank v. Talbot*, 131 Cal. 45; 63 Pac. 172.

² *Society of Practical Knowledge v. Abbot*, 2 Beav. 559; *Ooregum Gold Mining Co. v. Roper* (1892), A. C. 125.

So in Canada. *North-West Electric Co. v. Walsh*, 29 Can. Sup. Ct. 33 (where the company declared the shares forfeited for non-payment of the full par value).

De Ruvigne's Case, 5 Ch. D. 306, and other similar cases, which are sometimes cited as inconsistent with this rule (see 2 Clark & Marshall on Priv. Corps., § 401 a), proceed on principles elsewhere explained. See *infra*, § 1619. Cf. *Innes & Co.* (1903), 2 Ch. 254; *Leinster Contract Corp.* (1902), 1 Ir. 349.

As to what amounts to an issue at a discount, see *Midland Electric, etc. Co.*, 37 W. R. 471.

See also *infra*, § 785, as to issue for property, services, etc.

³ *Welton v. Saffery* (1897), A. C. 299.

Cf. *Ooregum Gold Mining Co. v. Roper* (1892), A. C. 125; *Weymouth*,

etc. Steam Packet Co. (1891), 1 Ch. 66.

⁴ *Society of Practical Knowledge v. Abbot*, 2 Beav. 559.

But see *Gold Co.*, 11 Ch. D. 701.

⁵ *Goodnow v. Am. Writing Paper Co.* (N. J.), 66 Atl. 607; *Green v. Abietine Med. Co.*, 96 Cal. 322; 31 Pac. 100; *Arnold v. Searing* (N. J. Ch.), 67 Atl. 831 (holding that a person claiming under such a contract is not within the rule that a plaintiff in equity must come into court with clean hands).

⁶ *Rickerson Roller Mill Co. v. Farrell, etc. Co.*, 75 Fed. 554; 23 C. C. A. 302; *Handley v. Stutz*, 139 U. S. 417, 435-436; 11 Sup. Ct. 530; *Peter v. Union Mfg. Co.*, 56 Oh. St. 181; 46 N. E. 894; *Felker v. Sullivan* (Colo.), 83 Pac. 213.

But see *Morrow v. Nashville Iron & Steel Co.*, 87 Tenn. 262; 10 S. W. 495; 10 Am. St. Rep. 658; 3 L. R. A. 37; *Zelaya, etc. Co. v. Meyer*, 8 N. Y. Supp. 487; 28 N. Y. St. Rep. 759; *New Haven Trust Co. v. Gaffney*, 73 Conn. 480; 47 Atl. 760; *Easton Nat. Bank v. Am. Brick & Tile Co.* (N. J.), 64 Atl. 917 (an able opinion).

In some cases where issue at a discount is prohibited by statute,

creditors who contracted their claims with knowledge of the circumstances of the previous issue;¹ and consequently payment in full can be enforced only by or for the benefit of subsequent creditors of the company who were ignorant that the shares were not really fully paid,² or perhaps by dissenting shareholders.³

Even in England, so long as the company continues to be a going concern, a person to whom shares have been issued at a discount may repudiate the issue as *ultra vires*, rescind the contract, and have his name removed from the register of shareholders,⁴ unless indeed he be barred by laches.⁵ Of course it

the courts have held that the attempted issue for less than par is wholly void, so that the allottees neither enjoy the rights nor are subject to the liabilities of shareholders. 2 Clark & Marshall on Priv. Corps., p. 1231-1232.

¹ *Northwestern Mut. Life Ins. Co. v. Cotton Exch., etc. Co.*, 70 Fed. 155; *Bent v. Underdown*, 156 Ind. 516, 520; 60 N. E. 307 (where the subsequent creditors were held to have constructive notice by reason of the contract being embodied in the incorporation paper); *Cunningham v. Holly, Mason, Marks & Co.*, 121 Fed. 720; 58 C. C. A. 140; *Euston v. Edgar* (Mo.), 105 S. W. 773; *Colonial Trust Co. v. McMillan*, 188 Mo. 547; 87 S. W. 933; 107 Am. St. Rep. 335; *Meyer v. Ruby-Trust, etc. Co.*, 90 S. W. 821; 192 Mo. 162; *Lea v. Iron Belt Mercantile Co.* (Ala.), 42 So. 415.

But see *Easton Nat. Bank v. Am. Brick & Tile Co.* (N. J.), 64 Atl. 917.

² *Rickerson, etc. Co. v. Farrell, etc. Co.*, 75 Fed. 554; 23 C. C. A. 302; *Flinn v. Bagley*, 7 Fed. 785; *Handley v. Stutz*, 139 U. S. 417; 11 Sup. Ct. 530; *Berry v. Rood*, 168 Mo. 316, 333-335; 67 S. W. 644; *Honeyman v. Haughey* (N. J.), 66 Atl. 582.

Cf. *Hawley v. Upton*, 102 U. S. 314; *Gogebic Investment Co. v. Iron Chief Min. Co.*, 78 Wisc. 427; 47 N. W. 726; 23 Am. St. Rep. 417.

That subsequent creditors con-

tracted their claims in ignorance of the fact that shares had been issued at a discount will be presumed in the absence of allegation and proof to the contrary. *Northwestern Mut. Life Ins. Co. v. Cotton Exch., etc. Co.*, 46 Fed. 22.

It seems that this right of subsequent creditors is equitable as distinguished from legal. *First Nat. Bank v. Peavey*, 69 Fed. 455; *Thomson-Houston, etc. Co. v. Dallas, etc. Ry. Co.*, 54 Fed. 1001; 5 C. C. A. 11.

³ 2 Clark & Marshall on Priv. Corps., § 397.

Cf. *Foreman v. Bigelow*, 4 Cliff. 508; *Kraft v. Griffon Co.*, 82 N. Y. App. Div. 29; 81 N. Y. Supp. 438; *Dickerman v. Northern Trust Co.*, 176 U. S. 181, 202, 203; 20 Sup. Ct. 311 (indicating that minority shareholders have no right to object to issue of shares at a discount); *Sivin v. Mutual Match Co.* (N. J.), 66 Atl. 921 (where complaining shareholders failed being *in pari delicto*).

⁴ *Almada and Tirito Co.*, 38 Ch. D. 415 (overruling *Plaskynaston Tube Co.*, 23 Ch. D. 542, and *Ince Hall, etc. Co.*, 23 Ch. D. 545 n.); *Midland Electric, etc. Co.*, 37 W. R. 471; *Ex parte Higgins*, 60 L. T. 383.

⁵ *Railway Time Tables Co.*, 42 Ch. D. 98.

would be *ultra vires* for a corporation to pay out of its own funds, deposits, etc., ostensibly paid by subscribers to its capital.¹ On the other hand, where the subscriber is to pay for the shares in full, a collateral stipulation whereby the company agrees to buy a certain class of goods exclusively from him has been held to be unobjectionable and enforceable and not to amount to an issue of the shares at a discount;² but this decision certainly opens the way to the evasion of the rule against issuing shares at a discount, and perhaps, therefore, its soundness may be questioned.

§ 777. **Issue as Security for Debt of Company.** — The issue of shares as collateral security for a debt of the company seems to be upheld in America,³ although it may result in the company receiving for the shares less than their par value.⁴

§ 778. **Effect of striking down Stipulation for Exemption from Liability for full par Value of Shares.** — The effect of striking down an agreement which if valid would operate to release a subscriber from the payment of the full par value of the shares is to leave him subject to the normal liability of a shareholder, — that is, a liability to pay on call; and hence he cannot be held without due proof of a call as if he had promised to pay in full in cash upon allotment.⁵ Some cases hold, or seem to hold, that even where shares are deliberately issued for less than their par value, the only remedy is to rescind the contract of subscription *in toto*, and that the subscriber cannot under any circumstances be held liable for more than the amount which he agreed to pay, even where creditors are concerned;⁶ but, as stated in a former paragraph, this is not the general rule.⁷ The difficulty has sprung from failing to recognize the difference between a liability on the contract to take shares and the liability as shareholder.⁸ Until the subscriber has become an

¹ *Spackman v. Lattimore*, 3 Giff. 16. (headnote misleading); *Leinster Contract Corp.* (1902), 1 Ir. 349.

² *Bouchard v. Prince's Hall Restaurant*, 20 Times L. R. 574. Cf. *De Ruvigne's Case*, 5 Ch. D. 306 (supra, p. 627, n. 2); *Innes & Co.*

³ *Powell v. Blair*, 133 Pa. St. 550; 19 Atl. 559. (1903), 2 Ch. 254.

See also supra, § 224.

⁴ *Peterborough R.R. Co. v. Nashua, etc. R. R. Co.*, 59 N. H. 385. 17 Vict. L. R. 717; *North-West Electric Co. v. Walsh*, 29 Can. Sup.

⁵ *Granite Roofing Co. v. Michael*, 54 Md. 65. Ct. 33, and cases cited supra, § 776.

⁶ *DuPont v. Tilden*, 42 Fed. 87. ⁸ See infra, § 781, where the distinction is elaborated.

actual shareholder, he cannot be held liable unless the company is able and willing to issue to him shares which on payment of the amount stipulated to be paid by him shall be legally paid-up shares, and the only effect of striking down the provision for issue at a discount is to exempt him from any liability at all.¹ But after the shares have been issued, the liability to pay the par value "in meal or in malt" attaches *ratione tenuræ*,² and is, or should be, independent of any illegal stipulations in the contract of subscription.

§ 779. **Whether Prohibition of Issue of Shares at a Discount applies to Reissue of Shares, to Issue as Part of Increase of Capital or to other Issue of Shares by a going Concern.** — Rules of law forbidding the issue of shares for less than their par value, whether they be the result of judicial decisions or be laid down by the legislature, have no application to the reissue of shares which, having been once legally issued, have by forfeiture, gift, or in any other legal mode reverted to the company; but such shares may legally be reissued or sold for whatever can be obtained for them.³ According to some strong American authorities, the same thing is true of shares issued by way of increase of capital by a going concern.⁴ Indeed, according to high authority, wherever a corporation has carried on business with its original authorized capital not fully subscribed, so that the shares have

¹ *Ecuadorian Ass'n v. Ecuador Co.* (N. J.), 65 Atl. 1051. See *supra*, § 233 and *infra*, § 781, § 789.

² But see *Christensen v. Eno*, 106 N. Y. 97, 102; 12 N. E. 648; 60 Am. Rep. 429, where the court said, "The liability of a shareholder to pay for stock does not arise out of his relation but depends upon his contract, express or implied."

³ *Ramwell's Case*, 50 L. J. Ch. 827; *Mosher v. Sinnott*, 79 Pac. (Colo.) 742 (where the shares had been issued in exchange for property and were returned by the allottees as "treasury stock").

Cf. *Campbell v. McPhee*, 36 Wash. 593; 79 Pac. 206 (where the shares had not been fully paid by the first allottee and where the second allottee, being charged with notice of that fact, was held liable).

⁴ *Handley v. Stutz*, 139 U. S. 417; 11 Sup. Ct. 530; *Stein v. Howard*, 65 Cal. 616; 4 Pac. 662 (notwithstanding a statutory provision forbidding the issue of stock except for money, labor, or property, and declaring that all fictitious increase of stock shall be void); *Speer v. Bordeaux*, 79 Pac. (Colo.) 332.

But see *Rickerson Roller-Mill Co. v. Farrell, etc. Co.*, 75 Fed. 554; 23 C. C. A. 302 (attempting to distinguish *Handley v. Stutz*, *ubi supra*); *Jackson v. Traer*, 64 Iowa 469, 482; 20 N. W. 764; 52 Am. Rep. 449; *Kraft v. Griffon Co.*, 82 N. Y. App. Div. 29; 81 N. Y. Supp. 438; *Donald v. American Smelting, etc. Co.*, 62 N. J. Eq. 729; 48 Atl. 771 (issue enjoined at suit of a shareholder).

acquired a rating in the market, the unsubscribed shares of the original authorized capital may be issued for whatever they would bring in the market, even though less than par,¹ and if the shares have no market value they may be issued gratuitously.² The ground for these conclusions is, that where the capital of the company has been impaired by losses, so that its shares are selling below par, no one would be willing to subscribe for new shares at par, so that unless the new shares can be issued for less than par they cannot be issued at all. It is submitted, however, that this reasoning is fallacious. The proper course to pursue in such a case would be, first, to reduce the nominal capital until it corresponds with the actual capital as diminished by losses, and then the old shares will be worth par, and the new shares may likewise be issued at par.

§ 780. **Disregard by Directors of Resolution of Shareholders upon Increase of Capital forbidding Issue for less than par.** — This American rule which permits shares to be issued by an established corporation for less than par, provided their actual market value be paid, does not prevent the corporation — that is, the shareholders — from providing that no shares shall be issued even upon an increase of capital for less than their par value, and in that event the directors have no authority to issue them at a discount. If the directors should do so, and if the allottee had knowledge of the restriction on their powers, the transaction would be void: the allottee would get no title to the shares and would be subject to no liability as shareholder. At least, this, it is conceived, would be his position on principle. A learned court has held, however, that he can be compelled in such a case to pay the full par value of the shares, just as if the prohibition of issue at a discount originated in statute or law, and as if the obligation to pay the nominal value of the shares were an inseparable incident to their ownership.³

¹ *Clark v. Bever*, 139 U. S. 96; Civ. App. 58; 20 S. W. 1015; *Remington Automobile & Motor Co.*, 139 11 Sup. Ct. 468; *Kellerman v. Maier*, 116 Cal. 416; 48 Pac. 377; Fed. 766 (affirmed in 155 Fed. 345); *McDowell v. Lindsay*, 213 Pa. 591; *Vaughn v. Ala. Nat. Bank*, 42 So. 63 Atl. 130. 64; 143 Ala. 572.

Contra: *Jackson v. Traer*, 64 Iowa 469; 20 N. W. 764; 52 Am. Sup. Ct. 476. ² *Fogg v. Blair*, 139 U. S. 118; 11 Rep. 449. ³ *Peck v. Elliott*, 79 Fed. 10, 18-

Cf. *Mathis v. Pridham*, 1 Tex. 19; 24 C. C. A. 425; 38 L. R. A. 616.

§ 781. **Liability of Holder of Shares issued at Discount distinguished from Liability under executory Contract to pay less than par for paid-up Shares.** — The principle that a holder of shares issued at a discount is nevertheless liable to pay their full par value applies only when the shares have been actually issued and accepted by the allottee. An executory contract to issue paid-up shares cannot be enforced by the company or by its liquidator or receiver unless the company is able to issue shares which shall be truly and legally fully paid-up, not merely as against the corporation itself, but also against its creditors.¹ The same result — namely, that an executory contract to issue shares for less than their nominal value is unenforceable — is sometimes reached in America by the reasoning that the contract is illegal and therefore will not support an action.² If, however, the shares are actually issued as fully paid, while in fact and in law they are not fully paid, the allottee who accepts them not merely undergoes a liability to pay the full par value for the benefit of the company's creditors, but also is precluded from maintaining any claim against the company — at any rate, after it has gone into liquidation — for breach of its contract to issue paid-up shares.³ If a contract for the issue of fully paid-up shares at a discount be abandoned before the shares are issued, it would seem clear, on principle, that the subscriber may recover back any deposit he may have paid to the company on account of the shares.⁴

§ 782. **Effect of Impossibility of paying in the Mode specially stipulated.** — Inasmuch as a stipulation that a shareholder shall

¹ *Arnot's Case*, 36 Ch. D. 702; *Macdonald, Sons & Co.* (1894), 1 Ch. 89; *New Eberhardt Co. v. Menzies*, 43 Ch. D. 118; *Knox v. Childersburg Land Co.*, 86 Ala. 180; 5 So. 578; *Ecuadorian Ass'n v. Ecuador Co.*, 61 Atl. 481. Cf. *Barnes v. Brown*, 80 N. Y. 527. See also *supra*, § 233, § 778.

But see *Odessa Tramways v. Mendel*, 8 Ch. D. 235.

² Cf. *Nickerson v. English*, 142 Mass. 267; 8 N. E. 45; *Edgerton v. Electric Imp. Co.*, 50 N. J. Eq. 354; 24 Atl. 540; *Garrett v. Kansas City Coal Mining Co.*, 113 Mo. 330; 20 S. W. 965; 35 Am. St. Rep. 713 (where a bill to enforce the contract

against the company was held not sustainable).

Quære, whether the subscriber, according to this view, can recover back the amount paid by him under the contract. *Clarke v. Lincoln Lumber Co.*, 59 Wisc. 655; 18 N. W. 492; *Knowlton v. Conrees, etc. Spring Co.*, 57 N. Y. 518; *Spring Co. v. Knowlton*, 103 U. S. 49; 2 Clark & Marshall on Priv. Corps., pp. 1235–1236.

³ *Addlestone Linoleum Co.*, 37 Ch. D. 191.

⁴ *Spring Co. v. Knowlton*, 103 U. S. 49 (headnote misleading). But cf. *supra*, note 2.

not be liable to pay the full nominal amount of his shares is void, it follows that if the special mode of payment stipulated for in the subscription becomes for any reason impracticable, payment of the full par value of the shares must be made in cash. For example, where the agreement is that payment shall be effected by setting-off calls against the price of goods to be ordered by the company from the shareholder, if the company goes into liquidation, and therefore can purchase no more goods, payment must be made in cash.¹

§ 783. **Stipulations for Payment at fixed Dates instead of on Call.** — Similarly, a special agreement by which the shareholder is to pay at some fixed future date does not exempt him from liability to pay before that time if the company is wound up before that date arrives.² Where a subscription is made on the terms that payment shall be made in instalments payable on certain fixed dates, a demand for payment of such instalments is not a call, and need not comply with the formalities required with respect to giving notice of a call.³

§ 784. **Statutes requiring Shares to be paid up before a certain Time.** — A statute requiring the entire capital of the company to be paid in within a certain time will, as between the corporation and the shareholder, be construed as directory merely.⁴ Hence, a subscription upon the understanding that payment shall be made in small weekly instalments, so that the payment would not be finished within the period prescribed by the statute, the subscription is not void, nor can it be treated as a contract to pay within the statutory period so as to cause the statute of limitations to run in favor of the shareholder from the expiration thereof.⁵

§ 785. **Payment in Property or Services.** — Inasmuch as subscriptions on special terms are competent, it follows that the

¹ *Elkington's Case*, 2 Ch. 511; *Leiter*, 145 Cal. 696; 79 Pac. 441.
Bridger's Case, 5 Ch. 305.

Cf. *Thomson's Case*, 4 De G. J. & S. 749; *Vogeler v. Punch* (Mo.), 103 S. W. 1001 (headnote inadequate — refusal of company to accept services which were to be in payment for stock held not to deprive stock of its paid-up character). But see *Paducah, etc. Railroad v. Parks*, 86 Tenn. 554; 8 S. W. 842.

² *Croskey v. Bank of Wales*, 4 Giff. 314, 331-332; *Morrison v. Dorsey*, 48 Md. 461. See also *supra*, § 740.

³ *Cordova Union Gold Co.* (1891), 2 Ch. 580. ⁴ Cf. *Phoenix Warehousing Co. v. Badger*, 67 N. Y. 294, 300.

⁵ *Frank v. Morrison*, 55 Md. 399.

Cf. *Union Savings Bank v.*

company may agree with the subscriber to accept payment in property, or in work and labor in lieu of cash.¹ Indeed, agreements of this sort are exceedingly common, and may even be said to constitute part of the usual scheme for the organization of corporations. For example, a company is incorporated to work a certain mine, to develop certain patents, or to operate a certain factory; the vendors of the mine, the patents, or the factory, receive payment in shares issued as fully paid; and at the same time other shares likewise issued as fully paid are bestowed on the promoters and attorneys of the company in payment for services rendered or supposed to have been rendered in and about the incorporation of the company. Unless the matter be the subject of special statutory regulation, the issue of fully paid shares in this way is entirely lawful. Shares may, by special contract between the company and the allottee, be issued either for money or for money's worth.²

Not only so, but according to the weight of reason and authority the value placed by the company on the property transferred or services rendered in exchange for the shares is conclusive,³

¹ *Drummond's Case*, 4 Ch. 772; *Pell's Case*, 5 Ch. 11; *Baglan Hall Colliery Co.*, 5 Ch. 346; *Philadelphia, etc. R. R. Co. v. Hickman*, 28 Pa. St. 318; *Bank of Fort Madison v. Alden*, 129 U. S. 372, 378-379; 9 Sup. Ct. 332; *Liebke v. Knapp*, 79 Mo. 22; 49 Am. Rep. 212; *Dayton, etc. R. R. Co. v. Hatch*, 1 Disney (Ohio) 84; *Phelan v. Hazard*, 5 Dillon 45; *Brant v. Ehlen*, 59 Md. 1; *Vogeler v. Punch* (Mo.), 103 S. W. 1001 (services part of which were to be rendered in the future, and which future services the company refused to accept).

But see *Pellat's Case*, 2 Ch. 527; *Black & Co.'s Case*, 8 Ch. 254, 265; *Coddington v. Canaday*, 157 Ind. 243, 262-263; 61 N. E. 567. For a full consideration of the question, see Frost on Incorporation and Organization of Corporations, § 104-§ 106, where the conflicting authorities are reviewed and classified.

² It was once judicially declared that the goodwill of a partnership

was "of too unsubstantial and shadowy nature to be capable of pecuniary estimation in this connection," and therefore could not be used to pay for shares. *Camden v. Stuart*, 144 U. S. 104, 115; 12 Sup. Ct. 585. But see contra: *Washburn v. National Wall-Paper Co.*, 81 Fed. 17; 26 C. C. A. 312; *White, Corbin & Co. v. Jones*, 79 N. Y. App. Div. 373; 79 N. Y. Supp. 583. Cf. *See v. Heppenheimer* (N. J.), 61 Atl. 843.

It has been said that payment in Confederate currency could not be accepted instead of payment in lawful money. *Macon, etc. R. R. Co. v. Vason*, 57 Ga. 314.

³ *Pell's Case*, 5 Ch. 11; *Baglan Hall Colliery Co.*, 5 Ch. 346; *Re Wragg* (1897), 1 Ch. 796; *Chapman's Case* (1895), 1 Ch. 771; *Bank of Fort Madison v. Alden*, 129 U. S. 372, 378-379; 9 Sup. Ct. 332; *Hess Mfg. Co.*, 23 Can. Sup. Ct. 644; 2 Clark & Marshall on Priv. Corps. § 401 e.

But see *Camden v. Stuart*, 144

unless the agreement to overvalue the services or property be obtained by fraud practised by the allottee upon the company, or unless the overvaluation is intentional and the result of a collusive scheme between the company and the allottee for the purpose of evading the law which prohibits the issue of shares at a discount.¹ To be sure, so long as the agreement of subscription remains executory, any shareholder may enjoin its consummation unless the value of the property to be accepted in payment is in fact equal to the nominal value of the shares irrespective of the valuation which the directors may have honestly placed upon it;² but after the shares have been issued the holder is protected from any further liability in the absence of fraud or collusion. Hence, if the shareholder refuse to convey the land which was to be transferred in payment for the shares, the company can recover from him merely the real value

U. S. 104; 12 Sup. Ct. 585; *Taylor v. Cummings*, 127 Fed. 108; 62 C. C. A. 108 (where the valuation of the company was based on an error in bookkeeping); *Meyer v. Ruby-Trust, etc. Co.*, 90 S. W. 821; 192 Mo. 162; *Shickle v. Watts*, 94 Mo. 410; 7 S. W. 274; *Berry v. Rood*, 168 Mo. 316; 67 S. W. 644.

A fortiori, the rule stated in the text applies where payment in property, etc., is expressly authorized by statute. *Coit v. Gold Amalgamating Co.*, 119 U. S. 343; 7 Sup. Ct. 231; *Bank v. Bellington Coal, etc. Co.*, 51 W. Va. 60; 41 S. E. 390; *Richardson v. Treasure Hill, etc. Co.*, 65 Pac. 74; 23 Utah 366.

Cf. *Buck v. Jones*, 70 Pac. 951; 18 Colo. App. 250 (where the shareholder was held liable because the title to the property sought to be conveyed in payment of his subscription had failed).

¹ *Re Wragg* (1897), 1 Ch. 796; *Lloyd v. Preston*, 146 U. S. 630; 13 Sup. Ct. 131; *Northwestern Mut. Life Ins. Co. v. Cotton Exch., etc. Co.*, 46 Fed. 22; *Boulton Carbon Co. v. Mills*, 78 Iowa 460; 43 N. W. 290; 5 L. R. A. 649; *Arapahoe, etc. Co. v. Stevens*, 13 Colo. 534; 22 Pac. 823;

Flour City Nat. Bank v. Shire, 88 N. Y. App. Div. 401; 84 N. Y. Supp. 810; affirmed short, 179 N. Y. 587; 72 N. E. 1141; *Dean v. Baldwin*, 99 Ill. App. 582 (formulae for compounding dyes taken at overvaluation); *See v. Heppenheimer* (N. J.), 61 Atl. 843; *Hobgood v. Ehlen* (N. Car.), 53 S. E. 857; *Strickland v. Nat. Salt Co.* (N. J.), 64 Atl. 982 (semble); *Honeyman v. Haughey* (N. J.), 66 Atl. 582.

Cf. *Innes & Co.* (1903), 2 Ch. 254 (*quære*, whether this case is in harmony with other English cases); *Easton Nat. Bank v. Am. Brick & Tile Co.* (N. J.), 64 Atl. 1095; *Leinster Contract Corp.* (1902), 1 Ir. 349 (a case difficult to reconcile with the English decisions); *Hood v. Eden*, 36 Can. Sup. Ct. 476.

In any case, according to the prevalent American rule, the shares would be deemed fully paid except as against subsequent creditors or dissenting shareholders.

See *supra*, § 776, and *Miller v. Higginbotham* (Ky.), 93 S. W. 655.

² *Donald v. American Smelting, etc. Co.*, 48 Atl. 771; 62 N. J. Eq. 729.

of the land and not necessarily the nominal value of the shares.¹ The fact that the vendors agree to surrender some of the shares to the company as "treasury stock" to be sold for less than par has been held not to be conclusive evidence that the arrangement is a mere device to issue the shares at a discount; for it was thought that the vendors might honestly believe the property sold to be worth the nominal value of the shares, and yet might be willing to surrender and sacrifice part of the shares with a view to increasing the value of the remainder.² Such decisions show how reluctant some courts are to strike down palpable evasions of the law. Of course, very great disparity between the value of the property or of the services accepted in payment for shares and the nominal value of the shares is very strong evidence to prove that the arrangement is a mere collusive device to enable shares to be issued at a discount;³ and, as intimated above, if such a device or evasion be established, the allottee could be held for the difference between the actual value of the property transferred or services rendered and the par value of the shares,⁴ to the same extent as if the shares had been openly issued at a discount of that amount.⁵

Even though no such fraud or collusion be proved, the agreement to credit the shares as fully paid must be supported by some legal consideration. For example, if the shares are issued as fully paid upon a past consideration, — for example, in con-

¹ *Dayton, etc. R. R. Co. v. Hatch*, 1 Disney (Oh.) 84.

² *Lake Superior Iron Co. v. Drexel*, 90 N. Y. 87.

Cf. *Davis Bros. v. Montgomery Furnace, etc. Co.*, 101 Ala. 127; 8 So. 496; *Finletter v. Acetylene Light Co.*, 215 Pa. 86; 64 Atl. 429 (where the person to whom the shares were issued as fully paid presented some of them as a bonus to other persons for subscribing).

³ *Coit v. Gold Amalgamating Co.*, 119 U. S. 343, 345; 7 Sup. Ct. 231 (semble); *Coleman v. Howe*, 154 Ill. 458; 39 N. E. 725; 45 Am. St. Rep. 133; *Macbeth v. Banfield*, 78 Pac. (Oreg.) 693; 45 Oreg. 553; 106 Am. St. Rep. 670; *Lester v. Bemis Lumber Co.*, 74 S. W. 518; 71 Ark. 379.

⁴ *Wallace v. Carpenter Mfg. Co.*, 70 Minn. 321; 73 N. W. 189; 68 Am. St. Rep. 530; *Coleman v. Howe*, 154 Ill. 458; 39 N. E. 725; 45 Am. St. Rep. 133; *Macbeth v. Banfield*, 78 Pac. 693; 45 Oreg. 553; 106 Am. St. Rep. 670; *Remington Automobile & Motor Co.*, 139 Fed. 766 (where the directors naively placed a valuation upon the property lower than the par value of the shares), affirmed, 153 Fed. 345; *Rathbone v. Ayer*, 105 N. Y. Supp. 1041 (where property which promoters had just bought for \$85,000 was turned over to the corporation at a valuation of \$500,000). See also cases cited *supra*, p. 635, n. 1.

⁵ As to this see *supra*, § 776.

sideration of past services gratuitously rendered, — the case stands precisely as if the shares had been issued as fully paid without any pretence of consideration.¹

The property or services which the corporation accepts in payment for its shares must of course be such as it has power to acquire or receive, and pay for out of its funds;² but if the company accepts in payment property which the law forbids it to hold, the subscriber cannot insist on a rescission of the contract and a cancellation of the shares, inasmuch as he is a conspirator *in pari delicto*.³

§ 786. **Evils of "Watered Stock."** — This liberty of contract by which the corporation and the allottee of shares are permitted to engraft upon the subscription such special terms as they please has led to the abuse which is known in America as "watered stock." Shares are issued as fully paid but representing little or nothing of real value. The company's nominal capital is placed at a fabulous, inflated figure; and unwary investors — "lambs" in the language of the stock-exchange — are deceived into believing that a company with so large a capital must have sufficiently strong financial support to insure its success. Evils of this sort are even greater than the danger that the company will obtain credit on the faith of its largely fictitious capital; for although the law is very solicitous about the rights of creditors, yet experience shows that creditors and money-lenders are usually sharp-sighted enough to guard themselves from imposition. It is investors in the company's securities, and the public at large, upon whom the evil weighs most heavily. At all events, the rules of law which prohibit fraudulent or collusive overvaluations of property accepted in payment for shares afford little or no protection. In the first place, it is usually impossible to prove the fraud or collusion. Moreover, even if the proof be forthcoming, the fraudulent allottees will have "un-

¹ *Eddystone Marine Ins. Co. v. res* part of the agreement has been (1893), 3 Ch. 9. fully executed by transfer of the

Cf. *Chapman's Case* (1895), 1 Ch. 771, where the consideration was property which the company has no alleged to be "illusory." power to hold, the subscriber cannot be compelled to pay over again in

² *Lester v. Bemis Lumber Co.*, 74 S. W. 518; 71 Ark. 379. cash).

³ *Continental Securities Co. v. But see East N. Y., etc. R. R. Co. Northern Securities Co.*, 57 Atl. 876; *v. Lighthall*, 36 How. Pr. (N. Y.) 66 N. J. Eq. 274.

481 (holding that after the *ultra*

loaded" the shares upon an unsuspecting public before the transaction is questioned, and the transferees being *bona fide* purchasers will be protected from any liability to make good the "water"; and even the original allottees who were parties to the collusive overvaluation are not, according to the prevalent American rule, under any obligation to make good the deficiency except for the benefit of subsequent creditors. Upon the whole, therefore, the situation demanded some remedial legislation. And the legislatures on both sides of the Atlantic have recognized the necessity for intervention, although the remedies applied have not always been either judicious or efficacious.

§ 787-§ 799. STATUTORY ATTEMPTS TO REMEDY EVILS OF WATERED CAPITAL.

§ 787. *Companies Act of 1867 — In general.* — In Great Britain an attempt was made by the Companies Act of 1867 to remove or at least diminish the evils above referred to. Section 25 of that statute enacted as follows: "Every share in any company shall be deemed and taken to have been issued and to be held subject to the payment of the whole amount thereof in cash, unless the same shall have been otherwise determined by a contract duly made in writing, and filed with the registrar of joint-stock companies at or before the issue of the shares."¹ In other words, the act left untouched the power of companies to stipulate with allottees of shares to accept payment in property or services or anything which the company might deem of value but it aimed to secure publicity and prevent fraud and deception by the provision that the special contract for payment otherwise than in cash should be filed with the registrar and thus exhibited to the public. A company might accept payment in peppercorns, if the directors honestly believed them to be worth the par value of the shares; but if so, the fact of such payment must be disclosed to the public. If the contract was not recorded, the shareholder was bound to pay the value of the shares in cash, even though he might have given full value in property or services.

§ 788. *Importance to American lawyers of Cases arising under this Statute.* — The cases which arose under this Act of 1867,

¹ 30 & 31 Vict., c. 131, sec. 25.

which was repealed by the Companies Act of 1900, are important to American lawyers not merely because an understanding of them is essential to a thorough comprehension of the historical development of English law, but also for the more practical reason that they have a direct bearing upon the construction of some American statutes passed with a similar object.

§ 789. *Act not applicable to executory Contracts to issue Shares.* — In the first place, the act applied only when shares had actually been issued; in a case of a mere agreement to issue shares credited as paid-up, the law remained as before the passage of the act — that is to say, the company could not hold the allottee liable unless it were ready and willing to issue shares which could subject the holder to no possible liability.¹

§ 790. *Act functus officio when Contract Registered.* — If the contract was duly registered, the act was *functus officio*, and the liability of the shareholder remained as before its passage. Hence, the registration of a contract to issue shares for a money consideration less than their nominal value was no protection against the liability to pay the difference;² but the valuation placed by the company in the registered contract upon property or services received in lieu of cash was conclusive in the absence of fraud or collusion.³ On the other hand, the consideration must be real and not illusory,⁴ and a “past” or executed consideration was not sufficient;⁵ for in these cases there was no binding contract at all.

§ 791. *Who charged with Burden of seeing to Registration of Contract.* — The act did not throw upon the company the burden of seeing to the registration of the contract, so as to estop it from claiming a benefit from a failure to register the same.⁶ On the contrary, any shareholder who claimed exemption from liability

¹ *Macdonald, Sons & Co.* (1894), 1 Ch. 89. Cf. *supra*, § 233, § 781.

As to when shares are deemed to be issued, see *supra*, § 170 et seq.

² *Ooregum Gold Mining Co. v. Roper* (1892), A. C. 125; *Welton v. Saffery* (1897), A. C. 299.

³ *Re Wragg* (1897), 1 Ch. 796; *Chapman's Case* (1895), 1 Ch. 771; *Anderson's Case*, 7 Ch. D. 75.

Cf. *Ames's Case*, W. N. (1896) 79.

⁴ *Anderson's Case*, 7 Ch. D. 75; *Chapman's Case* (1895), 1 Ch. 771.

But see *Leinster Contract Corp.* (1902), 1 Ir. 349.

⁵ *Eddystone Marine Ins. Co.* (1893), 3 Ch. 9.

⁶ Neither is that burden thrown on the shareholder or applicant for shares; but the party who asserts the shares to be fully paid must prove the registration of the contract. *Arnot's Case*, 36 Ch. D. 702.

registered and reissue the shares.¹ Only in that way and under those conditions could the shareholder obtain relief; and, accordingly, the Companies Act of 1898² was passed to enable the rectification of the register *nunc pro tunc* under an order of court.³ Finally, the hardships of the Act of 1867 led to its repeal.⁴

§ 794. *What is "Payment in Cash."* — Perhaps the point of most general importance that ever arose under Section 25 of the Companies Act of 1867 was the question what was necessary to constitute "payment in cash." The courts held that those words did not mean necessarily payment in actual coin or currency, but included any transaction that would have supported a plea of payment as distinguished from a plea of accord and satisfaction under the old common-law procedure.⁵ Hence, where a shareholder, being indebted to the company in respect of his shares and having at the same time a present overdue claim against the company, arising out of an independent transaction for goods sold and delivered or for work and labor, agrees with the corporation that the mutual debts shall be set off and a balance struck, the transaction amounts to payment in cash.⁶ So, it has been held that where a shareholder's alleged claim against the corporation is compromised on the basis of the company crediting a certain amount on the claimant's shares, the transaction amounts to payment in cash.⁷ Moreover, a present liability of the company may be set off against the potential or future liability for calls not yet made.⁸ On the other hand, an agreement to set off an unmatured claim against the

¹ *Hartley's Case*, 10 Ch. 157.

Cf. *Smith v. Brown* (1896), A. C. 614.

² 61 & 62 Vict., c. 26.

³ See *Jackson & Co.* (1899), 1 Ch. 348; *Jarvis's Case* (1899), 1 Ch. 193; *Re Maynards* (1898), 1 Ch. 515; *Whitehead & Co.* (1900), 1 Ch. 804; *Roxburghe Press* (1899), 1 Ch. 210; *Stephenson's Case* (1900), 2 Ch. 442; *Ebenezer Timmins & Sons* (1902), 1 Ch. 238; *Re Archibald D. Dawney, Ltd.*, 83 L. T. 47; *Smithson's Case*, 68 L. J. Ch. 46, in which cases the act was considered.

⁴ See *infra*, § 797.

⁵ *Spargo's Case*, 8 Ch. 407, 414.

⁶ *Spargo's Case*, 8 Ch. 407;

Adamson's Case, 18 Eq. 670; *North Sydney Investment Co. v. Higgins* (1899), A. C. 263; *Barrow-in-Furness Land Co.*, 14 Ch. D. 400; *Ex parte Bentley*, 12 Ch. D. 850; *Laroque v. Beauchemin* (1897), A. C. 358; *Ex parte Bentinck*, 1 Megone 12; *Ramwell's Case*, 50 L. J. Ch. 827.

⁷ *Ferrao's Case*, 9 Ch. 355.

Cf. *Barrow-in-Furness Land Co.*, 14 Ch. D. 400.

⁸ *Jones, Lloyd & Co.*, 41 Ch. D. 159. Cf. *Ex parte Bentinck*, 1 Megone 12; *Ramwell's Case*, 50 L. J. Ch. 827.

company — for example, a claim on bonds or debentures not yet due — against the shareholder's liability is not payment in cash.¹ Moreover, in order to bring a transaction within the rule in *Spargo's Case*, cited above, it is indispensable that the company should at some moment of time be under an obligation to pay in money. For example, where the company buys goods or orders services performed with the understanding that payment shall be made in fully paid shares, and shares are accordingly issued as fully paid, the company was at no time bound to pay otherwise than in shares, and therefore there is no payment for the shares in cash.² So, where a corporation purchases land under an agreement to pay either in money or, at its option, in fully paid shares, there being no absolute obligation on the company's part to pay in money, shares allotted in pursuance of the contract cannot be deemed to have been paid for in cash.³ Conversely, the doctrine of *Spargo's Case* cannot be applied unless the shareholder was at one time under an obligation to pay for his shares in money; hence, where shares are issued to a creditor as fully paid in satisfaction of his claim, the shares are not paid for in cash.⁴

§ 795. *Objections to the Companies Act of 1867.* — Some method of enforcing publicity as to the property which is accepted in payment for shares of stock is probably the true remedy for the conditions which occasioned in England the passage of the Act of 1867. Nevertheless, in its practical operation, that statute gave rise to much dissatisfaction. Persons to whom "watered" shares were issued almost invariably took pains to see that the contract was duly filed with the registrar. "Unfortunately," said Vaughan Williams, J., "those are not the persons who are caught in the legislative net. The cases which are generally hit by the section are where persons whom the liquidator wishes to place on the list of contributories have made honest agreements to pay for the shares, not in actual cash, but in something else which is really equivalent to a cash payment; and then by the negligence or mistake of some one, perhaps a clerk or solicitor,

¹ *Habershon's Case*, 5 Eq. 286;
Kent's Case, 39 Ch. D. 259.

² *Barrow's Case*, 14 Ch. D. 432.

³ *Pagin and Gill's Case*, 6 Ch. D. 1 Ch. 119.

⁴ *Johannesburg Hotel Co.* (1891),

681; *Andress's Case*, 8 Ch. D. 126;
White's Case, 12 Ch. D. 511.

the contract is not registered, the section takes effect, and the shareholder has to pay over again, and goes away with a sense that the law has done him an injustice.”¹

§ 796. **Companies Act of 1900.** — These objections to the Act of 1867 finally brought about its repeal by the Companies Act of 1900.² This latter statute, while repealing *in toto* the obnoxious provision of the Act of 1867 which invalidated unrecorded contracts to accept payment for shares otherwise than in cash, does not abandon the attempt to secure publicity; on the contrary it requires the company to register all such contracts or agreements;³ and although non-compliance with these provisions does not subject the shareholder to any liability, yet a heavy penalty is imposed on directors or officers who are responsible therefor.⁴ In other words, the act does not subject the subscribers to the shares to any burden other than that which they agreed to assume (except in case of fraud or collusive overvaluation), but visits with severe penalties the officers of a company who issue shares which are not to be paid for in cash without recording for public inspection the contract which shows precisely what is to be accepted in payment in lieu of cash. Another provision of the Act of 1900 requires certain deposits to be paid by applicants before allotment.⁵ Under this section, it is held that while the delivery of a cheque may perhaps be treated as the actual receipt of the deposit if the cheque is after the allotment duly honored, yet if the cheque is not eventually honored the allotment is voidable even though the company may receive the amount of the deposit from an underwriter.⁶

§ 797–§ 799. *American Statutes.*

§ 797. **Statutes requiring Payment in Cash — What amounts to Payment in Cash.** — Statutes requiring shares to be paid for in cash, either absolutely or conditionally, — that is, unless certain requirements and conditions are met, — are sometimes encountered in America. Probably they should receive the same

¹ *Preservation Syndicate* (1895),
2 Ch. 768, 771, per Vaughan Wil-
liams, J.

² 63 & 64 Vict., c. 48, § 33.

³ *Ibid.*, § 7(1).

⁴ *Ibid.*, § 7(2).

⁵ *Ibid.*, § 4.

⁶ *Mears v. Western Canada, etc.*
Co. (1905), 2 Ch. 353.

construction in respect to the meaning of "payment in cash" as the English Companies Act of 1867.¹ A cheque on a bank in which the drawer has sufficient funds may be accepted as cash;² but the law seems to be different if the drawer had no sufficient funds to his credit, even though the cheque if presented would have been honored.³ Of course, the subscriber's own promissory note cannot be deemed money;⁴ the giving of a note is really not payment, but rather a deferring of payment.

§ 798. **Statutes forbidding Issue of Shares except in Exchange for Money, Property, or Services.** — A not uncommon statutory provision in the United States — sometimes even embodied in state constitutions — is that shares shall not be issued except in exchange for money, property, or services. Such provisions would seem to add little or nothing to the law as laid down in England under the Companies Act of 1862 in respect to what will constitute payment for shares.⁵ They have been construed

¹ *Beach v. Smith*, 30 N. Y. 116; *Veeder v. Mudgett*, 95 N. Y. 295, 315.

Cf. *Laroque v. Beauchemin* (1897), A. C. 358 (where a Quebec statute was construed by the Privy Council); *Turner v. Cowan*, 34 Can. Sup. Ct. 160 (transfer of property nominally for cash to be set-off against liability upon subscription to shares not payment in cash within meaning of British Columbia statute); *Morris v. Union Bank*, 31 Can. Sup. Ct. 594; *People ex rel. New York Central, etc. R. R. Co. v. Public Service Commission*, 106 N. Y. Supp. 968 (where the transaction was held to be a mere form and not a real payment of cash); *State ex rel. Attorney-General v. Wood*, 13 Mo. App. 139; *Breck v. Barney*, 183 Mass. 133; 66 N. E. 643; *Clarke v. Lexington Stoveworks*, 72 S. W. 286; 24 Ky. Law Rep. 1755; 73 S. W. 288; *Harvey-Watts Co. v. Worcester Umbrella Co.* (Mass.), 78 N. E. 886.

² *People v. Stockton, etc. R. R. Co.*, 45 Cal. 306; 13 Am. Rep. 178; *Syracuse, etc. R. R. Co. v. Gere*, 4 Hun (N. Y.) 392.

But see *People ex rel. N. Y., etc. R. R. Co. v. Railroad Comm'rs*, 81

N. Y. App. Div. 242; 81 N. Y. Supp. 20; affirmed short, 67 N. E. 1088; 175 N. Y. 516.

³ *People ex rel. Plumas County v. Chambers*, 42 Cal. 201.

⁴ *Leighty v. Pres., etc. of Turnpike Co.*, 14 Serg. & R. (Pa.) 434; *Williams v. Brewster*, 93 N. W. 479; 117 Wisc. 370.

⁵ See *Grant v. East & West R. R. Co.*, 54 Fed. 569; 4 C. C. A. 511; *Brown v. Duluth, etc. Ry. Co.*, 53 Fed. 889; *Pacific Trust Co. v. Dorsey*, 72 Cal. 55; 12 Pac. 49; *Van Cleve v. Berkey*, 143 Mo. 109; 44 S. W. 743; 42 L. R. A. 593; *Rogers v. Gladiator, etc. Co.* (S. Dak.), 113 N. W. 86; *Andrews v. Nat. Foundry, etc. Works*, 76 Fed. 166; 22 C. C. A. 110; 77 Fed. 774; 23 C. C. A. 454; *Speer v. Bordeleau*, 79 Pac. (Colo.) 332; *Lake St. El. R. Co. v. Ziegler*, 99 Fed. 114; 39 C. C. A. 431; *Toledo, etc. R. R. Co. v. Continental Trust Co.*, 95 Fed. 497; 36 C. C. A. 155; *Finletter v. Acetylene Light Co.*, 215 Pa. 86 (headnote inadequate); 64 Atl. 429; *Vaughn v. Ala. Nat. Bank*, 42 So. 64; 143 Ala. 572; 2 Clark & Marshall on Priv. Corps., § 391.

Cf. *Altenberg v. Grant*, 85 Fed.

in a multitude of not altogether harmonious decisions. An additional provision that all "fictitious increase of stock" shall be "void" is troublesome and dangerous.¹ Statutes of this class are either useless or pernicious. If construed conservatively, they are scarcely more than declaratory, and are therefore superfluous; if construed loosely, they are less tolerable than the evils they were intended to remedy.

§ 799. **Statutes requiring Recording of Contracts for Payment for Shares otherwise than in Cash.** — The expedient of requiring the recording of contracts for the issue of shares otherwise than subject to payment of their full amount in cash has heretofore been but seldom resorted to in the United States. Such a provision is contained in a recent Massachusetts incorporation law.² A somewhat similar law has long been in force in Maryland,³ but has received a very different interpretation from the Companies Act of 1867.⁴ By requiring agreements for payment for shares otherwise than in cash to be recorded, freedom of contract is preserved, while at the same time the evils of "watered stock" are reduced to a minimum. Similar statutes are not unlikely to be enacted in other states.

§ 800-§ 801. *Estoppel of Company to exact Payment for Shares which have not been paid-up.*

§ 800. **Estoppel in favor of a Transferee of Shares.** — Although shares are not negotiable, yet they have many of the attributes of negotiability,⁵ and are at any rate exempted from the common-law rule which forbids the assignment of the legal title to choses in action. Hence, shares which in the hands of the original

345; 29 C. C. A. 185 (construing a slightly different provision). See also *infra*, § 1695.

¹ Cf. *Coler v. Tacoma Ry., etc. Co.*, 65 N. J. Eq. 347; 54 Atl. 413; 103 Am. St. Rep. 786 (holding that when the corporation gives an option of \$35 in cash or \$100 in stock, the stock in excess of \$35 par value is "fictitious"). See also *infra*, § 1695.

² Mass. Acts, 1903, chap. 437, § 11, § 14.

³ Md. Code Pub. Gen. Laws (1888), Art. 23, § 62-§ 65.

⁴ *Baile v. Calvert College, etc. Soc.*, 47 Md. 117; *Southern Trust, etc. Co. v. Yeatman*, 134 Fed. 810; 67 C. C. A. 456; *Weber v. Fickey*, 52 Md. 501.

Cf. *McDowell v. Lindsay*, 213 Pa. 591; 63 Atl. 130 (construing a W. Va. statute requiring a publication of notice of an intention to issue stock for less than par).

⁵ See *infra*, § 837 et seq., § 912 et seq.

allottee are subject to calls may nevertheless be deemed fully paid in the hands of a *bona fide* purchaser without notice of the circumstances of the issue. For example, where the certificates issued by the corporation to an original allottee state erroneously that the shares are fully paid or that only a certain sum remains to be paid thereon, the company will be estopped from holding a *bona fide* transferee thereof to any greater liability than would have attached if the representation in the certificate had been true.¹ The same principle applies although a statute may expressly enact that shares shall be paid for in cash to their full amount unless certain conditions be complied with; for such statutes do not exclude the application of the principle of estoppel although payment may not have been made as required by the legislature.²

The purchaser may be protected even though the share-certificate, in compliance with a statutory requirement, expressly states that the shares are issued for property purchased by the company.³ *A fortiori* the fact that the certificate states the shares to be fully paid up without disclosing how they were paid up, whether in cash or otherwise, is not sufficient to charge a purchaser with notice that payment was not made in cash as required by law.⁴ Moreover, the fact that the transferee knew that some shares had been issued otherwise than for cash will not put him upon inquiry whether the shares assigned to him were among that number.⁵ The transferee may safely rely upon the company's representation that the shares are fully paid, and cannot

¹ *Waterhouse v. Jamieson*, L. R. 1004; *Barrow's Case*, 14 Ch. D. 432; 2 H. L. (Scotch) 29; *Brant v. Ehlen*, 59 Md. 1; *Foreman v. Bigelow*, 4 Cliff. 508; *Steacy v. Little Rock, etc. R. R. Co.*, 5 Dillon 348; *Morgan v. Howland*, 89 Me. 484; 36 Atl. 990; *Du Pont v. Tilden*, 42 Fed. 87 (a confused case); *Rood v. Wharton*, 67 Fed. 434; *Fraser River Mining, etc. Co. v. Gallagher*, 5 Brit. Columb. 82.

As to whether in such cases the transferee is under any statutory liability to creditors as a holder of shares not fully paid, see *White, Corbin & Co. v. Jones*, 167 N. Y. 158; 60 N. E. 422.

² *Burkinshaw v. Nicolls*, 3 A. C.

1004; *Barrow's Case*, 14 Ch. D. 432; *Sprague v. National Bank of America*, 172 Ill. 149; 50 N. E. 19; 64 Am. St. Rep. 17; 42 L. R. A. 606; *Remington Automobile & Motor Co.*, 153 Fed. 345.

Cf. *Berry v. Rood*, 168 Mo. 316, 332-333; 67 S. W. 644.

³ *Easton Nat. Bank v. American Brick, etc. Co.*, 60 Atl. (N. J.) 54; reversed as to other points, 64 Atl. 917.

⁴ *Burkinshaw v. Nicolls*, 3 A. C. 1004, 1021.

⁵ *A. W. Hall & Co.*, 37 Ch. D. 712; *New Chile Gold Mining Co.*, 68 L. T. 15.

be charged with notice of the actual facts merely because "the slightest inquiry would have disclosed" the truth.¹ In order to hold a purchaser, where the shares purport to be fully paid, it must be both alleged and affirmatively proved that he took with notice.²

A purchaser with notice from a purchaser without notice succeeds to all the latter's rights,³ even though the second transferee was an officer of the company when the shares were issued;⁴ but the burden of proof is on the second purchaser to show that his assignor took without notice of the circumstances under which the shares were issued.⁵ A pledgor who has notice cannot, after payment of the debt to secure which the shares were pledged, claim the rights of a *bona fide* purchaser because the pledgee had no notice.⁶ Where the transferee is protected as a purchaser for value, it would seem that the transferor or original allottee should remain liable.⁷

The clearest case of representation by the company that shares have been fully paid is where the representation is contained in the official certificate issued by the corporation.⁸ Some cases hold that a *bona fide* purchaser will be protected unless the certificate shows affirmatively that the shares are not fully paid even though the certificate does not state that the shares are paid-up.⁹ Any representation brought home to the company

¹ *Waterhouse v. Jamieson*, L. R. 307; 68 N. W. 691; 61 Am. St. Rep. 238; 2 H. L. (Scotch) 29.

But cf. *Garden City Sand Co. v. American, etc. Crematory Co.*, 205 Ill. 42; 68 N. E. 724 (where a purchaser was deemed to have had such knowledge as a reasonable man in his position would have had).

² *Burkinshaw v. Nicolls*, 3 A. C. 1004, 1017-1018; *A. W. Hall & Co.*, 37 Ch. D. 712; *Hess v. Trumbo*, 84 S. W. 1153; 27 Ky. Law Rep. 320.

Cf. *Higgins v. Illinois Trust, etc. Bank*, 193 Ill. 394; 61 N. E. 1024 (where the transferee was held to be affected with notice).

³ *Barrow's Case*, 14 Ch. D. 432.

⁴ *Barrow's Case*, 14 Ch. D. 432.

⁵ *Wallace v. Carpenter, etc. Mfg. Co.*, 70 Minn. 321; 73 N. W. 189; 68 Am. St. Rep. 530.

Cf. *Wishard v. Hansen*, 99 Iowa

⁶ *Erskine v. Loewenstein*, 82 Mo. 301, 305-306 (headnote inadequate). See also *infra*, § 914.

⁷ *Supra*, § 765.

⁸ A statement in the certificate that the shares though fully paid are liable to "assessment" will prevent a transferee from claiming the rights of a purchaser for value without notice. *Wishard v. Hansen*, 99 Iowa 307; 68 N. W. 691; 61 Am. St. Rep. 238; *Western Improvement Co. v. Des Moines Nat. Bank*, 103 Iowa 455; 72 N. W. 657.

⁹ *West Nashville Planing-Mill Co. v. Nashville Savings Bank*, 86 Tenn. 252; 6 S. W. 340; 6 Am. St. Rep. 835.

though not contained in the certificate will be sufficient to raise the estoppel. For instance, where the secretary represented to a transferee of shares that a certificate stating the shares to be fully paid had been lodged with him, whereas in fact no certificate at all or none stating the shares to be paid-up had been deposited with him, the company was held in England to be estopped from denying the shares to be paid-up to the prejudice of the transferee;¹ but this decision is discredited, if not overruled, by a later case in the House of Lords.² Indeed, the estoppel is not ordinarily or easily raised by mere parol declarations of officers³ or in any other way than by the issue of a certificate.

§ 801. **Estoppel in favor of Original Allottee.** — In some exceptional cases the principle of estoppel may have the effect of exonerating even the original allottee from liability although the shares had not in fact been paid for.⁴ Thus, where a corporation pledges its own shares as security for a loan, issuing to the creditor a certificate stating that the shares have been paid up in full, the company is estopped from holding the creditor liable as shareholder on the ground that in fact the shares were not paid up.⁵ The company might have had power to issue the shares as collateral if they had been fully paid; for example, a person who had paid for shares in full *might* have been willing to support the company's credit to the extent of the value of the shares, and therefore the creditor was justified in relying on the company's representation. In the same way, where P gave W a sum of money to be used in paying for one hundred fully paid shares to be issued to P, and W instead of carrying out this arrangement procured certain unpaid shares to be issued to P, the certificate, however, falsely stating the shares to be fully paid, the court held that the company was estopped from holding P, although he was an original allottee, as the

¹ *McKay's Case* (1896), 2 Ch. "treasury stock"); *Remington Automobile & Motor Co.*, 153 Fed. 345, 757.

² *George Whitechurch, Ltd. v.* 349 (as to the Taber stock).

Cavanaugh (1902), A. C. 117.

³ *Bloomenthal v. Ford* (1897),

⁴ *Browning v. Hinkle*, 48 Minn. A. C. 156; *Gasquet v. Crescent City* 544 (headnote inadequate); 51 N. *Brewing Co.*, 49 Fed. 496.

W. 605; 31 Am. St. Rep. 691.

Cf. *Otter v. Brevoort Petroleum*

⁵ Cf. *Berry v. Rood*, 168 Mo. 316, *Co.*, 50 Barb. 247.

332; 67 S. W. 644 (as to purchase of

holder of unpaid shares.¹ However, in such cases the burden of disproving notice of the fact that shares are not paid-up as represented always rests on the allottee.²

§ 802-§ 806. *Assessments on paid-up Shares.*

§ 802. **In general not lawful.** — Limited liability is at common law one of the most important and fundamental characteristics of a corporation. Often it furnishes the chief incentive to the organization of a corporation instead of a partnership or voluntary association. The essence of this limited liability is that members of the corporation who have paid in full for their shares — that is to say, who have contributed to the common fund, or the capital of the company, all that they agreed to put in — are under no further liability whatsoever.³ This feature is part of the very constitution of the company, and is indeed the condition upon which alone the several shareholders consent to become members. Hence, the corporation has no power by internal regulations or by-laws to alter this rule, or to levy calls or assessments upon the holders of shares previously issued and fully paid.⁴ To be sure, by-laws may perhaps impose upon holders of fully paid shares fines for breaches of any reasonable regulations of the company;⁵ but this power is quite different from a power to levy assessments for the purpose of raising funds.

§ 803. **Assessments by Consent of Shareholders.** — Even, however, in the case of a limited company, the shareholders, by

¹ *Parbury's Case* (1896), 1 Ch. 100; *Kettle River Mines v. Bleasdel*, 7 Brit. Columb. 507 (to substantially the same effect).

² *Parbury's Case* (1896), 1 Ch. 100, 106 (headnote inadequate).

³ 1 Morawetz on Priv. Corps., 2d ed., 131; 2 Clark & Marshall on Priv. Corps., § 403.

⁴ *Gresham v. Island City Savings Bank*, 2 Tex. Civ. App. 52; 21 S. W. 556; *Wells v. Green Bay, etc. Co.*, 90 Wisc. 442; 64 N. W. 69; *Trustees of Free Schools v. Flint*, 13 Metc. (Mass.) 539; *Reid v. Eatonton Mfg. Co.*, 40 Ga. 98; 2 Am. Rep. 563; *Redkey Citizens, etc. Co. v. Orr*, 60

N. E. 716; 27 Ind. App. 1 (where the defendant had voted in favor of the assessment); *Sullivan County Club v. Butler*, 26 N. Y. Misc. 306; 56 N. Y. Supp. 1; *Enterprise Ditch Co. v. Moffitt*, 58 Nebr. 642; 79 N. W. 560; 45 L. R. A. 647; 76 Am. St. Rep. 122; *Moore v. New Jersey Lighterage Co.*, 57 N. Y. Super. Ct. 1; 5 N. Y. Supp. 192; *Great Falls, etc. R. R. v. Copp*, 38 N. H. 124.

But cf. *Omaha Law Library Ass'n v. Connell*, 55 Nebr. 396; 75 N. W. 837.

⁵ See supra, § 716.

provision in their regulations, may contract that they shall be liable in excess of the limit for the purpose of adjusting the equities *inter sese*, and in that event shares subsequently issued will be accepted subject to the liability, which may accordingly be enforced by the corporation.¹ A person who has become entitled to paid-up, non-assessable shares does not, it would seem, waive his rights, or become liable to pay assessments on the shares, by accepting a certificate which states that the shares are "non-assessable beyond ten dollars per annum" or by signing a receipt which states that the shares are held subject to the by-laws, which by-laws although attempting to authorize the assessments were adopted after his right to non-assessable shares had accrued.² If shareholders agree among themselves to pay certain assessments on full-paid shares, a holder who pledges his shares to the company to secure the payment of the assessment cannot subsequently refuse to pay on ground that the assessment was *ultra vires*.³

§ 804. **Assessments authorized by Statute.** — The power to levy assessments on the holders of fully paid shares is sometimes conferred by statute.⁴ Such statutes being in derogation of the

¹ *Maxwell's Case*, 20 Eq. 585; (holding that the agreement of *Mirage Irrigation Co. v. Sturgeon* (Nebr.), 108 N. W. 977 (headnote inadequate — a case where shareholders accepted certificates expressly providing that the shares were held subject to the power of the company to levy assessments over and above the par value); *Weeks v. Silver Islet Consol. Mining Co.*, 55 N. Y. Sup. Ct. 1 (provision in share-certificate for forfeiture for non-payment of assessments enforced).

Cf. *Redkey Citizens, etc. Co. v. Orr*, 60 N. E. 716; 27 Ind. App. 1 (holding that agreement of shareholders *inter sese* after issue of shares cannot be enforced by company); *Omaha Law Library Ass'n v. Connell*, 55 Nebr. 396; 75 N. W. 837 (where liability to pay "dues," recognized expressly by the by-laws and impliedly by the incorporation paper, was held to be enforceable by the corporation); *Flint v. Pierce*, 99 Mass. 68; 96 Am. Dec. 691

(holding that the agreement of shareholders made by signing the by-laws cannot be enforced by creditors). As to whether money voluntarily paid by the shareholders to the corporation is to be treated as lent or given to the company, see *Bidwell v. Pittsburgh, etc. Ry. Co.*, 114 Pa. St. 535; 6 Atl. 729 (where the transaction was held to be a gift); *Leavitt v. Oxford, etc. Co.*, 3 Utah 265; 1 Pac. 356; *Atlas Loan Co.*, 9 Ont. L. R. 468; and *infra*, § 1316.

² *Sullivan County Club v. Butler*, 26 N. Y. Misc. 306; 56 N. Y. Supp. 1.

³ *Platt v. Birmingham Axle Co.*, 41 Conn. 255.

⁴ *Gardner v. Hope Ins. Co.*, 9 R. I. 194; 11 Am. Rep. 238 (where the statute was passed after the shares were issued, in pursuance of a reserved power to alter or repeal the act of incorporation); *Santa Cruz R. R. Co. v. Spreckles*, 65 Cal. 193;

common law will be strictly construed. Thus, a statute authorizing a corporation to provide for payment of debts by assessment on the shareholders or otherwise has been construed as authorizing assessments upon paid-up shares for the purpose of discharging such debts only as by another statute the shareholders are individually liable to pay.¹ So, a statute providing that in case the capital should be impaired by losses, the directors should "forthwith repair the same by assessment," was construed as merely preventing the company from continuing business with impaired capital, and not as imposing any personal liability upon the several shareholders to make good the deficiency for the benefit of creditors where the directors had refused to levy an assessment and had preferred to throw the company into liquidation.² If the statute authorizes assessments for certain purposes, no assessment will be enforceable which is not for those purposes exclusively.³ A provision that the shares shall not be liable to assessment after the capital stock has been paid in except by consent of three-fourths of the shareholders does impliedly authorize assessments on paid-up shares, but only after the capital stock shall have been completely subscribed and paid in.⁴ A prohibition of any assessments so long as the company has "treasury stock" undisposed of does not apply where the treasury stock is valueless and unsalable.⁵ On the other hand, a statutory provision that any corporation may assess upon each share of stock such sums of money as the company may think proper, not exceeding the par value of the stock, has been con-

3 Pac. 661, 802 (where the statute which was held to authorize the assessment was by no means unambiguous); *Younglove v. Steinman*, 80 Cal. 375; 22 Pac. 189 (statute authorizing assessment for "paying expenses, conducting business or paying debts" held to authorize assessment for necessary repairs); *Gary v. York Mining Co.*, 9 Utah 464; 35 Pac. 494.

Cf. *Enterprise Ditch Co. v. Moffitt*, 58 Nebr. 642; 79 N. W. 560; 45 L. R. A. 647; 76 Am. St. Rep. 122 (where a statute authorizing assessments was held unconstitutional as applied to shares previously issued); *Ireland v. Palestine, etc. Turnpike*

Co., 19 Oh. St. 369 (same point); *Sparks v. Lower Payette Ditch Co.*, 2 Idaho 1030; 29 Pac. 134 (upholding statute authorizing assessments where by pre-existing law each shareholder would have been personally liable for his proportion of the corporate indebtedness).

¹ *Ossipee, etc. Mfg. Co. v. Canney*, 54 N. H. 295, 315-318.

² *Dewey v. St. Albans Trust Co.*, 57 Vt. 332.

³ *Lancaster Starch Co. v. Moore*, 62 N. H. 671.

⁴ *Atlantic De Laine Co. v. Mason*, 5 R. I. 463.

⁵ *Jones v. Bonanza Mining, etc. Co.* (Utah), 91 Pac. 273, 277.

strued as conferring a power to assess paid-up shares and to forfeit the shares for non-payment.¹ Even where an express statute authorizes assessments on paid-up shares, it might be sometimes held that the company's only remedy is by forfeiting the shares for non-payment and that the several shareholders are subject to no personal liability for the assessment.² It was conceded by the court in a Pennsylvania case that the corporation might by internal regulation or by-law limit its statutory power to assess paid-up shares.³ If this be correct, the liability for assessments should be carefully distinguished from a liability to creditors, which, if imposed by statute, certainly cannot be waived by the corporation. It has been said that even where the power exists to levy assessments on fully paid shares, it cannot be exercised, in the absence of some element of waiver, unless the entire capital has been subscribed;⁴ but, as we have seen, the defence that the capital has not been fully subscribed is not available against an action for calls where the company has with the defendant's consent begun business and incurred obligations, and as this is almost always the case before a power to levy assessments on fully paid shares is exercised, the defence would seem to be rarely available.

§ 805. **Assessments in Reorganization.** — Sometimes, under schemes of reorganization, so-called assessments are levied on holders of paid-up shares; but although in practice the payment of such assessments is virtually compulsory, since shareholders who refuse to pay will be excluded by foreclosure or otherwise from participation in the reorganization, yet in the theory of the law the shareholders are quite at liberty to pay or not to pay, as they please.

§ 806. **Attempts to evade Rule Prohibiting Assessments on paid-up Shares.** — The rule of law prohibiting compulsory assessments upon paid-up shares cannot be circumvented by any device. Hence, a contract whereby the entire business and

¹ *Price's Appeal*, 106 Pa. St. 421. *Co.*, 96 Cal. 322; 31 Pac. 100 (where

² But see *Santa Cruz R. R. Co. v. Spreckles*, 65 Cal. 193; 3 Pac. 661, 802 (where defendant was held personally liable). an assessment was sustained on shares issued as fully paid-up and unassessable).

³ *Price's Appeal*, 106 Pa. St. 421, 424. ⁴ *Sullivan County Club v. Butler*, 26 N. Y. Misc. 306; 56 N. Y. Supp. 1.

But cf. *Green v. Abietine Med.*

undertaking of a corporation is to be sold to a new company in consideration of partly paid shares in the new company and of the assumption by the new company of the debts of the old, with a stipulation that in the winding-up of the old company the partly paid shares received from the new company should be distributed among the shareholders of the old company and that the quota of any shareholder who should refuse to accept the same should be sold and the proceeds applied in reduction of the debts which the new company agreed to assume, is *ultra vires* of the old company, even though the company had power to sell its undertaking in exchange for partly paid shares;¹ for the whole agreement is an obvious scheme to force the shareholders to accept partly paid shares in lieu of fully paid shares. The same result has been reached where the proceeds of sale of the quota of the dissentient shareholders of the old company in the shares of the new company were to be distributed among such dissentient shareholders *pro rata*.²

§ 807. **Liability of Shareholders to Creditors.** — At common law, the liability of shareholders to pay the par value of their shares is owing to the corporation alone and not to its creditors. The rights of creditors are derivative, although to be sure, as explained above, the law sometimes strikes down agreements between the subscriber and the company which, so far as the corporation is concerned, would be quite harmless, but which if enforced would be prejudicial to creditors. In addition to these derivative rights of creditors, statutes often impose upon the several shareholders further liabilities in their favor. Both the common-law, or derivative, and the statutory, or direct, rights of creditors against the shareholders are of little practical importance so long as the corporation is prosperous. A business corporation must, as a practical matter, either pay its debts when judicially ascertained or withdraw from business. Consequently the various rights of creditors against the shareholders, whether direct or indirect, are closely connected with the subject of

¹ *Manners v. St. David's Gold, etc. Co.* (1904), 2 Ch. 593.

² *Bisgood v. Nils Valley Co.* (1906), 1 Ch. 747.

winding-up and dissolution, and therefore are excluded from this work. For this reason it is unnecessary here to classify the various statutes subjecting shareholders to liabilities to creditors of greater or less extent, or to digest the multitudinous cases in which such statutes have been construed or applied.

CHAPTER XIV

FORFEITURE OF SHARES

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§ 808-§ 810. *Authority of Corporation to Forfeit Shares.*

§ 808. In general — Whether Forfeiture amounts to illegal Reduction of Capital. — Breaches of duty on the part of shareholders and more particularly breaches of duty in non-payment of calls are usually punishable by forfeiture of their shares. The forfeiture may take the form of a strict forfeiture, by which the forfeited shares revert to the company; but sometimes the shares

are to be sold for the account of the delinquent holder. Not even strict forfeitures are illegal as a reduction of capital¹ for several reasons. In the first place, the incorporation laws, as a rule, either expressly authorize forfeiture of shares for non-payment of calls or else contain provisions which impliedly contemplate it. Secondly, the forfeiture involves no reduction of the actual capital, but at most affects the nominal capital. Lastly, forfeiture for non-payment of calls is within the rule (which seems to be supported by the authorities) permitting a company to accept a surrender of shares in satisfaction of a debt of which payment could be obtained in no other way.²

§ 809. **Whether Power may be Conferred by By-law without Statutory Authority.** — Where forfeiture of shares is not affirmatively authorized by statute, a considerable number of authorities hold that the company has no power to provide therefor by its by-laws or regulations;³ but on principle the contrary might well be held, since a forfeiture is a reasonable means of compelling the shareholders to perform their duties.⁴ Of course, any by-law or regulation attempting to impose a forfeiture for the doing of any act which the shareholder has an absolute right to do, such as entering suit against the company on a *bona fide* claim, would be void.⁵ In practice, forfeitures are rarely imposed except for non-payment of calls.

The statutes or regulations authorizing the imposition of the penalty of forfeiture should be strictly construed; and in order that a forfeiture should be held valid all the terms and conditions must be strictly complied with.⁶

¹ *Trevor v. Whitworth*, 12 A. C. 458; *Mueller v. Madison Bldg., etc. Ass'n*, 11 S. Dak. 43; 75 N. W. 277; *Dronfield Silkstone Coal Co.*, 17 Ch. D. 76, 79, 84, per Jessel, M. R.

² See *supra*, § 638.

³ *Long Island R. R. Co.*, 19 Wend. 37; 32 Am. Dec. 429; *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413, 417; 15 Pac. 659; 3 Am. Rep. 169 (semble); *Purdy v. Bankers' Life Ass'n (Mo.)*, 74 S. W. 486; 101 Mo. App. 91; *March v. Fairmount Creamery Ass'n*, 32 Pa. Sup. Ct. 517 (supportable on another ground, for which see *supra*, § 718).

Cf. *Pulford v. Fire Dept.*, 31 Mich.

458; *Mueller v. Madison Bldg., etc. Ass'n*, 11 S. Dak. 43; 75 N. W. 277; *Lesseps v. Architects' Co.*, 4 La. Ann. 316 (where the shareholders had assented to the by-law); *Kirk v. Nowill*, 1 T. R. 118; *Minnehaha Driving Park Ass'n v. Legg*, 50 Minn. 333, 334; *Barton's Case*, 4 De G. & J. 46.

⁴ See *supra*, § 716.

⁵ *Hope v. International Financial Soc.*, 4 Ch. D. 327; and cases cited *supra*, § 718.

Cf. *Allnutt v. Subsidiary High Court*, 62 Mich. 110; 28 N. W. 802.

⁶ *Johnson v. Lytle's Iron Agency*,

§ 810. **Whether Power affected by a Charge on Uncalled Capital.** — The power of the company to enforce a forfeiture of shares for non-payment of calls is not affected by the fact that the company may have issued bonds or debentures secured by a charge on the unpaid capital.¹

§ 811-§ 814. *Notice of Forfeiture.*

§ 811. **Necessity for Notice.** — Notice of some sort to the delinquent is usually prescribed in order to enable him to perform his duties and thus prevent the forfeiture. Even in the absence, however, of any affirmative requirement of notice, it is submitted that notice should be essential to the validity of a forfeiture,² although at least one decision dispenses with the necessity of notice.³ A provision for notice *after* the forfeiture has been consummated and become absolute is directory merely, and a failure to give the notice does not undo the forfeiture;⁴ but as we shall presently see, the inclination of the courts is to hold that the forfeiture was not intended to become absolute until the expiration of the notice. In any case of forfeiture for non-payment of calls, it is of course necessary that the calls should be valid,⁵ and consequently that any notice of the call that may be essential to its enforceability should be given.⁶

5 Ch. D. 687; *Morris v. Metalline Land Co.*, 164 Pa. St. 326; 30 Atl. 240; 44 Am. St. Rep. 614; 27 L. R. A. 305; *Clarke v. Hart*, 6 H. L. Cas. 633; *Westcott v. Minnesota Mining Co.*, 23 Mich. 145; *York, etc. R. R. Co. v. Ritchie*, 40 Me. 425; *Dearborn v. Washington Sav. Bank*, 18 Wash. 8; 50 Pac. 575; *Crissey v. Cook*, 72 Pac. 541; 67 Kans. 20 (semble); *Corcoran v. Sonora Mining, etc. Co.*, 71 Pac. 127; 8 Idaho 651; *Germantown Pass. Ry. Co. v. Fidler*, 60 Pa. St. 124.

¹ *Agency Land & Finance Co.*, 20 Times L. R. 41.

² *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536; *Pulford v. Fire Dept.*, 31 Mich. 458; *Delacy v. Neuse Nav. Co.*, 1 Hawks (N. Car.) 274; 9 Am. Dec. 636.

Cf. *supra*, p. 580, n. 1.

³ *Germantown Passenger Ry. Co. v. Fidler*, 60 Pa. St. 124; 100 Am. Dec. 546.

⁴ *Knight's Case*, 2 Ch. 321.

⁵ *Garden Gully Mining Co. v. McLister*, 1 A. C. 39; *Raht v. Sevier Mining, etc. Co.*, 18 Utah 290; 54 Pac. 889.

Where a forfeiture is declared for non-payment of several calls, it is invalid if any of the calls is invalid; *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451; 77 Am. Dec. 236.

⁶ *Morris v. Metalline Land Co.*, 164 Pa. St. 326; 30 Atl. 240; 44 Am. St. Rep. 614; 27 L. R. A. 305.

But see *Austin's Case*, 24 L. T. 932, upholding as *against* the company a forfeiture for non-payment of a call of which due notice had not been given.

The same notice is sometimes made to serve the double purpose of notifying the shareholder that a call has been made and of warning him that unless payment is made within a certain time the shares will be forfeited.

§ 812. **Requisites of Notice in general.** — Where notice of forfeiture is required, a notice expiring on an impossible date — *e. g.*, on Monday the 9th where the 9th falls on Friday — is bad.¹ A notice demanding, under pain of forfeiture, payment of a larger sum than is due is of no effect.² The notice must describe the shares truthfully; and if it contains a material misdescription, the resulting forfeiture will be invalid.³ It is not necessary that the notice should specify that failure to make payment as required will be followed by forfeiture.⁴ If the by-laws require a notice from the general secretary of the corporation, notice from a local secretary would be insufficient.⁵ Where notice of thirty days is required before the resolution declaring the forfeiture or ordering the sale, notice given thirty days before the sale is insufficient.⁶ If the statute require such notice as may be prescribed by by-law, there cannot be a valid forfeiture unless a by-law fixing the kind of notice be first adopted.⁷ A regulation providing that the notice must “require” the shareholder to pay is complied with if the notice indicate that failure to pay will be followed by forfeiture.⁸

§ 813. **Kind of Notice.** — **Constructive or Personal Notice, etc.** — Personal notice should be given where practicable. Indeed, the notice must be personal unless some form of constructive notice be provided for by statute or by-law.⁹ A notice which is taken to the shareholder’s last place of business and forwarded in pursuance of directions there found, but which in fact never reaches him, is not sufficient,¹⁰ unless the regulations provide that notice sent to the shareholder’s business address shall be good. Where notice by publication in a newspaper is directed by the

¹ *Watson v. Eales*, 23 Beav. 294. *ton*, 48 Me. 451; 77 Am. Dec.

² *Johnson v. Lyttle’s Iron Agency*, 236.
5 Ch. D. 687.

³ *Financial Corporation*, 2 Ch. *the Co.*, 32 Ont. R. 387.
714.

⁴ *Hill v. Nisbet*, 100 Ind. 341, R. 476.
355-356.

⁵ Cf. *Payn v. Mutual Relief Soc.*, *Cockerell*, 1 C. B. N. s. 732.
17 Abb. N. C. (N. Y.) 53.

⁶ *Lewey’s Island R. R. Co. v. Bol-* Ill. App. 258.

⁷ *Armstrong v. Merchants’ Man-*
the Co., 32 Ont. R. 387.

⁸ *Gray v. Stevenson*, 25 Vict. L.

⁹ *Van Diemen’s Land Co. v.*

¹⁰ *Fields v. United Brotherhood*, 60

company's regulations, it must be given; and not even personal notice to the delinquent will suffice to sustain the forfeiture unless the required publication is had.¹ So, if the by-laws require notice by mail or personal notice, notice by publication is ineffective, even though the notice as published was actually seen by the delinquent shareholder.²

§ 814. **To whom Notice should be given.** — Notice should be given to the registered owner of the shares.³ Hence, in case of a bankrupt shareholder whose assignee has not been registered on the company's books as a member, the notice should be given to the bankrupt although the company knows of the bankruptcy.⁴

§ 815–§ 816. *When Forfeiture becomes absolute.*

§ 815. **In general.** — The forfeiture becomes absolute at whatever time the regulations by which the company is governed so provide. Usually a formal declaration of forfeiture is passed. Certainly some such formality is desirable. Consequently, even where the regulations provide that, upon the happening of this or that event, the shares shall be forfeited without any further act on the company's part, nevertheless the construction will be, not that the shares become *ipso facto* forfeited, but that the company may at its option by some overt act enforce a forfeiture.⁵ Any legal evidence of an intention to exercise this option is sufficient to complete the forfeiture, a formal declaration of forfeiture by resolution of the directors or shareholders not being necessary,⁶ unless expressly required by statute or the company's

¹ *Morris v. Metalline Land Co.*, 164 Pa. St. 326; 30 Atl. 240; 44 Am. St. Rep. 614; 27 L. R. A. 305. *Child v. Hudson's Bay Co.*, 2 P. Wms. 207, 209; *Northwestern, etc. Ass'n, v. Schauss*, 148 Ill. 304; 35 N. E. 747.

² *Mitchell v. Vermont Copper Mining Co.*, 40 N. Y. Sup. Ct. 406, 413 (headnote inadequate). See *S. C.* 67 N. Y. 280. But see *Weeks v. Silver Islet, etc. Mining Co.*, 23 Jones & S. (N. Y.) 1; *Carr v. Carr*, 1 C. B. N. s. 197.

³ Cf. *Armstrong v. Merchants' Mantle Co.*, 32 Ont. R. 387. Cf. *Freckmann v. Supreme Council*, 96 Wisc. 133; 70 N. W. 1113 (as to mutual benefit societies); *Lehman v. Clark*, 174 Ill. 279; 51 N. E. 222; 43 L. R. A. 648 (as to mutual insurance companies); *McDonald v. Ross-Lewin*, 29 Hun (N. Y.) 87 (mutual benefit society); *Rood v. Railway Pass. etc. Ass'n*, 31 Fed. 62.

⁴ *Graham v. Van Diemen's Land Co.*, 1 H. & N. 541. ⁵ *Woollaston's Case*, 4 De G. & J.

Compare the cases as to notice of calls, *supra*, § 750.

⁶ *Bigg's Case*, 1 Eq. 309; *Moore v. Rawlins*, 6 C. B. N. s. 289; *Canal Co. v. Sansom*, 1 Binney (Pa.) 70;

regulations.¹ But a declaration of an intention to forfeit shares at some future day will not become absolute by mere lapse of time: there must be evidence of a *present* election to treat the shares as forfeited.² When the statute or by-law providing for the forfeiture requires a sale of the forfeited shares for the account of the delinquent holder, the forfeiture is not complete until such sale is had;³ but ordinarily it is no concern of the delinquent what is done by the company with the forfeited shares.⁴

§ 816. **Effect of Provision for Notice to Delinquent.** — Without the very clearest provision in the statute or by-law which regulates the forfeiture, the courts will refuse to hold that the forfeiture becomes absolute before the expiration of the prescribed notice.⁵ This is true although some of the language of the statute authorizing the forfeiture, if taken by itself, might seem to indicate that the forfeiture should become absolute before the expiration of the notice; for the very object of prescribing notice is to afford a period of grace before the extreme penalty is exacted.⁶

437; *Webster's Case*, 32 L. J. Ch. 135. Cf. *Crissey v. Cook*, 72 Pac. 541; 67 Kans. 20 (where the resolution was general, that all shares upon which defaults had been committed be forfeited).

But see *Clarke v. Hart*, 6 H. L. Cas. 633.

¹ *Edinburgh, etc. Ry. Co. v. Hebblewhite*, 6 M. & W. 707.

² *Macon, etc. R. R. Co. v. Vason*, 57 Ga. 314; *Hays v. Franklin Co. Lumber Co.*, 35 Nebr. 511 (headnote inadequate); 53 N. W. 381.

Cf. *Crissey v. Cook*, 72 Pac. 541; 67 Kans. 20.

³ *Minnehaha Driving Park Ass'n v. Legg*, 50 Minn. 333 (headnote inadequate); 52 N. W. 898. Cf. *Lewey's Island R. R. Co. v. Bolton*, 48 Me. 451; 77 Am. Dec. 236; *Dearborn v. Washington Sav. Bank*, 18 Wash. 8; 50 Pac. 575; *Moore v. Wheal Byjerkerno Tin Mining Co.*,

17 Vict. L. R. 680 (holding that if sale does not take place on day first advertised, a new notice of sale may be given, preserving, however, the delinquent's right of redemption until a sale is actually had). As to difference between a power to forfeit shares and a power to sell them and apply the proceeds in payment of the indebtedness, see § 955, and also *Athol, etc. R. R. Co. v. Prescott*, 110 Mass. 213; *Mueller v. Madison Bldg., etc. Ass'n*, 11 S. Dak. 43; 75 N. W. 277.

⁴ *Weeks v. Silver Islet, etc. Mining Co.*, 23 Jones & S. (N. Y.) 1, 14; *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536; *Murphy v. Patapsco Ins. Co.*, 6 Md. 99.

⁵ *Van Diemen's Land Co. v. Cockerell*, 1 C. B. N. s. 732.

⁶ *Van Diemen's Land Co. v. Cockerell*, 1 C. B. N. s. 732.

§ 817-§ 819. *Purging Forfeiture by Payment or Tender of Amount due.*

§ 817. **When and how Forfeiture may be Purged.** — At any time before the forfeiture becomes absolute, the delinquent may purge the forfeiture by paying the overdue calls with interest and expenses.¹ Tender of the amount due for calls will have the same effect as actual payment in preventing or purging a forfeiture;² and a tender of a cheque may be equivalent to a tender of cash if no objection be made on the ground that commercial paper instead of cash was offered.³ If the delinquent wishes to be relieved of the shares because his subscription was obtained by fraud but is not willing to run the risk of forfeiting money that he has already paid thereon, he may pay the overdue calls into court without prejudice to any right to have his membership rescinded; but he cannot have the forfeiture enjoined.⁴ After the forfeiture has once become absolute, not even a court of equity has jurisdiction to relieve against it, even though the delinquent should offer to pay all calls with interest as well as all damages and expenses of the company.⁵

§ 818. **Acceptance of Payment after Forfeiture has become Absolute.** — Even after the forfeiture has become absolute, it would seem that the acceptance by the company of the amount due on the shares would be equivalent to a waiver or cancellation of the forfeiture;⁶ but the fact that cases of former delinquencies

¹ *Van Diemen's Land Co. v. Cockerell*, 1 C. B. N. s. 732; *Mitchell v. Vermont Copper Mining Co.*, 67 N. Y. 280. Cf. *Bostock v. Edgar*, 24 Vict. L. R. 677 (holding that under the Victoria Companies Act the redemption does not relate back to the time of the delinquency, but that there is an interval during which the delinquent is not a shareholder).

² *Mitchell v. Vermont Copper Mining Co.*, 67 N. Y. 280; *Wilson v. Duplin Telephone Co.*, 52 S. E. 62; 139 N. Car. 395 (where the delinquent tendered more than the amount due).

³ *Clarke's Case*, 27 L. T. 843.

⁴ *Ripley v. Paper Bottle Co.*, 57 L. J. Ch. 327.

⁵ *Sparks v. Liverpool Waterworks Co.*, 13 Ves. 428; *Weeks v. Silver Islet, etc. Mining Co.*, 23 Jones & S. (N. Y.) 1; *Germantown Pass. Ry. Co. v. Filler*, 60 Pa. St. 124; 100 Am. Dec. 546.

⁶ Cf. *Lime City Bldg., etc. Ass'n v. Black*, 136 Ind. 544, 558-560; 35 N. E. 829; *Order of Chosen Friends v. Austerlitz*, 75 Ill. App. 75 (acceptance of a less sum in compromise); *Metropolitan Accident Ass'n v. Windover*, 137 Ill. 417; 27 N. E. 538; *Bartling v. Edwards*, 84 Ill. App. 471; *Supreme Tribe v. Hall*,

have not been visited with the penalty of forfeiture does not justify a member in failing to make prompt payment of calls subsequently made.¹

§ 819. **Effect of Set-off against Call.** — A forfeiture of shares for non-payment of calls is not invalidated by the fact that the supposedly delinquent shareholder has a good set-off against the calls.²

§ 820. **Effect of Judgment for Amount of Call on Right to enforce Forfeiture.** — It has been held that after a company has recovered judgment against a shareholder for an overdue call, it cannot subsequently enforce a forfeiture for default upon that very call;³ but this decision turned largely on the peculiar terms of the regulations by which that particular corporation was governed.

§ 821. **Effect of Company's Refusal to accord to Delinquent his full Rights as Shareholder.** — In one case it was held that a forfeiture for non-payment of assessments cannot be sustained where the shareholder's refusal to pay is induced by the company's refusal to permit him to exercise his right of examining the books;⁴ but it is difficult to see why the company should be subjected to this penalty for its failure to recognize the shareholder's right, and perhaps the decision was not intended to lay down a principle of general application.

§ 822. **Forfeiture invalid unless intended to benefit Company.** — No forfeiture should be enforced unless really beneficial to the company; and any forfeiture which is not believed *bona fide* to be for the good of the company may be set aside.⁵ For this

24 Ind. App. 316; 56 N. E. 780; 79 Am. St. Rep. 262; *Modern Woodmen v. Jameson*, 48 Kans. 718; 30 Pac. 460.

But see *Carr v. Carr*, 1 C. B. N. S. 197.

¹ *Harvey v. Grand Lodge*, 50 Mo. App. 472. But see *Moore v. Order of Railway Conductors*, 90 Iowa 721; 57 N. W. 623.

² *Johnson v. Lytle's Iron Agency*, 5 Ch. D. 687, 689, 692 (headnote inadequate). Cf. *supra*, § 759.

³ *Giles v. Hutt*, 3 Ex. 18.

⁴ *Buker v. Leighton Lea Ass'n*, 164 N. Y. 557; 58 N. E. 1085 (reversing s. c. 18 N. Y. App. Div. 548; 46 N. Y. Supp. 35; and affirming the dissenting opinion of Follett, J., in the court below).

⁵ *Richmond's Case*, 4 K. & J. 305; *Common v. McArthur*, 29 Can. Sup. Ct. 239.

Cf. *Hall's Case*, 5 Ch. 707.

reason a forfeiture of shares held by a person about whose solvency no doubt is entertained is in general invalid.¹ So, too, a forfeiture of shares on which nothing has been paid and which are not selling at a premium cannot well be advantageous to the company and is therefore invalid.² Similarly, an agreement by which a delinquent shareholder is allowed to retire upon payment of less than could have been collected from him if a forfeiture had been enforced cannot be supported as a forfeiture.³

§ 823. **Loss of Right to forfeit Shares by Waiver or Laches.** — The company's right to enforce a forfeiture may be lost by laches or waived by the company in any particular case.⁴ Any action or inaction on the company's part which would render the enforcement of the forfeiture unjust may be relied upon as establishing such a waiver. It has been held in Tennessee that where a corporation has the right to sell or forfeit shares for non-payment of each call as made, the company, after omitting to exercise that power as each call became due and having waited until a number of calls are made, loses by the delay its remedy by forfeiture or sale.⁵ This case stands alone, however, and one may well doubt whether the same doctrine would be applied in other states.⁶ Indeed, the decision is rested by the court itself upon the peculiar terms of the statute which was being construed, rather than upon any general principles of law.

§ 824. **Waiver by Shareholder of Irregularities in Forfeiture — Laches.** — Irregularities in a forfeiture of shares may be cured by waiver.⁷ For instance, an objection to a forfeiture of shares based upon the fact that in the notice and resolution of forfeiture the shares were described as £20 shares instead of, according to the real legal nature, as £100 shares, is waived by asking a remission of the forfeiture as a matter of grace.⁸ Mere laches will not, however, disentitle a shareholder to relief against an invalid forfeiture: there must be evidence of abandonment of

¹ *Manisty's Case*, 17 Sol. J. 745;
Esparto Trading Co., 12 Ch. D. 191.

² *Ex parte Jones*, 27 L. J. Ch. 666.

Cf. *Slee v. Broom*, 19 Johns. (N. Y.) 456; 10 Am. Dec. 273.

³ *Hall's Case*, 5 Ch. 707. Cf. supra, § 636.

⁴ Cf. supra, § 818.

⁵ *Stokes v. Lebanon, etc. Turnpike Co.*, 6 Humph. (Tenn.) 241.

⁶ See supra, § 818.

⁷ Cf. *Miller v. Grand Lodge*, 72 Mo. App. 499.

⁸ *Financial Corporation*, 2 Ch. 714.

his rights or some facts sufficient to estop him from attacking the forfeiture.¹

§ 825. **Waiver by the Company of Irregularities in Forfeiture.** — In some cases a shareholder who is anxious to retire sets up an irregular forfeiture and relies upon a waiver by the company to cure the irregularities.² Notably was this the case in a series of English decisions arising in the winding-up of the Agriculturists Cattle Company.³ That company was incorporated under the Companies Act of 1844 so that the liability of its members was unlimited: hence questions as to illegal reductions of capital, so important in the case of limited companies, did not arise. These cases, therefore, are of little or no general importance in America at the present day; and accordingly it has not seemed worth while to attempt a statement or explanation of their somewhat complicated facts.⁴

§ 826. **Surrender or Cancellation of Shares as equivalent to Forfeiture.** — Inasmuch as the company and the shareholder may respectively waive irregularities in the forfeiture, it follows that by agreement between them a formal forfeiture may be entirely dispensed with, the shares which are liable to forfeiture being surrendered or cancelled by agreement. But in order to be sustained as a forfeiture, any such cancellation or surrender of shares must have been intended as, in substance, a forfeiture.⁵

§ 827. **Remedies of Shareholder against Irregular or void Forfeiture.** — The shareholder has several remedies open to him against an irregular or void forfeiture. In general, he may have the same remedies by action for damages, writ of mandamus, or bill in equity, which are open to a shareholder whose name has been stricken from the list of members in pursuance of a forged or otherwise void transfer.⁶ He may have an action for damages,

¹ *Garden Gully Mining Co. v. 5 H. L. 606; Spackman v. Evans, McLister*, 1 A. C. 39. Cf. *Prendergast* L. R. 3 H. L. 171; *Houldsworth v. Turton*, 1 Y. & C. Ch. 98; *Rule v. Evans*, L. R. 3 H. L. 263.

Jewell, 18 Ch. D. 660; *Clarke v. Hart*, 6 H. L. Cas. 633; *Raht v. Sevier Mining, etc. Co.*, 18 Utah 290; 54 Pac. 889; *Ormsby v. Vermont Copper Mining Co.*, 56 N. Y. 623.

² *Crissey v. Cook*, 72 Pac. 541; 67 Kans. 20.

³ See *Evans v. Smallcombe*, L. R. 3 H. L. 249; *Dixon v. Evans*, L. R.

⁴ For a clear statement see Hamilton's Manual of Company Law, 2d ed., pp. 222-225.

⁵ *Esparto Trading Co.*, 12 Ch. D. 191. See also *Gower's Case*, 6 Eq. 77, and *supra*, § 636, § 822.

⁶ *Herbert Kraft Co. v. Bank of Orland*, 133 Cal. 64; 65 Pac. 143. See *infra*, § 935-§ 937.

as for a conversion, against the company.¹ Or, he may file a bill in equity to have the forfeiture annulled.² In such a suit he may pray a declaration that the forfeiture is void instead of a cancellation of the forfeiture and return of the shares; it is all one and deceives nobody.³ A bill in equity to enjoin an irregular forfeiture⁴ will not lie unless the plaintiff offers to do equity by paying any calls or assessments that may be overdue.⁵ An irregular forfeiture is to be distinguished from a void forfeiture; and therefore a statute of limitations restricting the period within which actions may be brought for the recovery of forfeited shares where the forfeiture is attacked because of some irregularity does not apply where the ground of attack is that the assessment for non-payment whereof the forfeiture was attempted was wholly void.⁶

§ 828-§ 831. *Consequences of Forfeiture of Shares.*

§ 828. **Effect of Forfeiture on Liability of Shareholder.** — The effect of a consummated forfeiture is that the holder of the forfeited shares ceases to be a member of the company from the moment when the forfeiture becomes absolute.⁷ From that time forth, he is a mere stranger to the company. Hence he is not

¹ *New Chile Gold Mining Co.*, 45 Ch. D. 598; *Allen v. Am. Bldg. & Loan Ass'n*, 49 Minn. 544; 52 N. W. 144; 32 Am. St. Rep. 574. As to the measure of damages in such an action, see *Budd v. Multnomah Street Ry. Co.*, 15 Oreg. 413, 419-420 (headnote inadequate); 15 Pac. 659; 3 Am. Rep. 169; *Carpenter v. Am. Building & Loan Ass'n*, 54 Minn. 403; 56 N. W. 95; 40 Am. St. Rep. 345; *Nicholson-Watson, etc. Co. v. Urquhart* (Tex.), 75 S. W. 45; 32 Tex. Civ. App. 527; *Grand Valley Irr. Co. v. Fruita Imp. Co.* (Colo.), 86 Pac. 324 (full value not recoverable where the shares were bought in by the shareholder).

² *Sweny v. Smith*, 7 Eq. 324 (holding that the bill may be filed on behalf of plaintiff and all other shareholders); *Wilson v. Duplin*

Telephone Co., 52 S. E. 62; 139 N. Car. 395.

As to the remedy by mandamus, see *Delacy v. Neuse Nav. Co.*, 1 Hawks (N. Car.) 274.

³ *Sweny v. Smith*, 7 Eq. 324, 333.

⁴ As to whether the remedy at law is adequate so as to exclude equity jurisdiction, see *Isbester v. Murphy Mfg. Co.*, 95 Ill. App. 105 (headnote inadequate).

⁵ *Burham v. San Francisco Fuse Mfg. Co.*, 76 Cal. 26; 17 Pac. 939. As to bills to enjoin a forfeiture of shares, see further *Schuetz v. German-American Real Estate Co.*, 21 N. Y. App. Div. 163; 47 N. Y. Supp. 500; *Moore v. N. J. Lighterage Co.*, 25 Jones & S. (N. Y.) 1.

⁶ *Herbert Kraft Co. v. Bank of Orland*, 65 Pac. 143; 133 Cal. 64.

⁷ *New Chile Gold Mining Co.*, 45 Ch. D. 598.

liable for calls or assessments subsequently made upon the shareholders.¹ It makes no difference that his name is not removed from the register of shareholders and that the company is in liquidation.² By the weight of authority, a forfeiture wipes out all liability upon the forfeited shares, even for calls made before the forfeiture;³ and the same rule is applied where the shareholder has given his note for the call or assessment in question,⁴ or where the company prior to the forfeiture had brought suit to recover the call.⁵ But according to some authorities and under some statutes, the holder of forfeited shares remains liable for the calls that were due at the time of the forfeiture;⁶ though the amount realized by the company from a sale of the forfeited shares must be credited in satisfaction *pro tanto* of any such liability.⁷ The question of course turns on the construction of the particular statute or other instrument which authorizes the forfeiture; and for this reason no general rule can be laid down. Cases of strict forfeiture may be governed, perhaps, by slightly different principles from cases of sale of the shares for the account of the delinquent holder.⁸ Where the regulations to which the corporation is subject provide that a holder of forfeited shares shall continue liable for all calls due at the time of forfeiture, such liability is an ordinary debt⁹ and is therefore not barred by any statute of limitations applicable to

¹ *Knight's Case*, 2 Ch. 321. Cf. *Webster's Case*, 32 L. J. Ch. 135.

² *Lyster's Case*, 4 Eq. 233.

³ *Stocken's Case*, 3 Ch. 412, 415 (semble); *Rutland, etc. R. R. Co. v. Thrall*, 35 Vt. 536; *Macaulay v. Robinson*, 18 La. Ann. 619; *Allen v. Montgomery R. R. Co.*, 11 Ala. 437; *Small v. Herkimer Mfg. Co.*, 2 N. Y. 330.

Cf. *Ladies Dress Ass'n v. Pulbrook* (1900), 2 Q. B. 376; *Mandel v. Swan Land Co.*, 154 Ill. 177; 40 N. E. 462; 45 Am. St. Rep. 124; 27 L. R. A. 313; *Instone v. Frankfort Bridge Co.*, 2 Bibb (Ky.) 576, 580-581; 5 Am. Dec. 638. See also *Mills v. Stewart*, 41 N. Y. 384, holding that a statutory liability directly to creditors is destroyed by a forfeiture, as if the defendant had never owned shares in the company.

⁴ *Ashton v. Burbank*, 2 Dillon 435. But see contra: *Mitchell v. Rome R. R. Co.*, 17 Ga. 574.

⁵ *Small v. Herkimer Mfg. Co.*, 2 N. Y. 330.

⁶ *Inglis v. Great Northern Ry. Co.*, 1 Macq. H. L. Cas. 112; *Great Northern Ry. Co. v. Kennedy*, 4 Exch. 417; *Succession of Thomson*, 46 La. Ann. 1074; 15 So. 379; *Carson v. Arctic Mining Co.*, 5 Mich. 288; *Merrimac Mining Co. v. Bagley*, 14 Mich. 501.

⁷ *Inglis v. Great Northern Ry. Co.*, 1 Macq. H. L. Cas. 112, 116.

⁸ *Carson v. Arctic Mining Co.*, 5 Mich. 288, 295 (holding that in a case of sale the delinquent remains liable).

⁹ As to right to defend against this liability on the ground of fraud, see *supra*, § 205.

claims against shareholders as such or as "contributories" in winding-up proceedings.¹ So, too, the liability which persists after a forfeiture is not affected by the company's acceptance of a material amendment to its charter or act of incorporation.² Of course, the mere fact that the company has taken some steps looking towards forfeiture but has not yet performed all the statutory requirements of a complete forfeiture will not release the shareholder from liability.³ A former holder of the forfeited shares who had transferred them prior to the forfeiture remains subject to any statutory liability attaching to past members,⁴ and *a fortiori* the person who held the shares at the time of the forfeiture is similarly liable.⁵ The same principles should be applied where the delinquent is a transferee of the shares and where he is an original subscriber.⁶

§ 829. **Sale or Reissue of Forfeited Shares.** — The forfeited shares may be sold by the company for less than their par value without violating any statute prohibiting the issue of shares at a discount.⁷ Where the shares are reissued and a certificate issued which states the amount which has been paid on the shares and that the remainder owing thereon has been called in but not paid, a further provision in the certificate that the shares shall be held discharged from all calls due prior to its date will not be construed to make the shares paid-up shares, but will merely prevent the vendee from being held in default for non-payment of the previous calls and therefore liable for interest thereon, leaving the company at liberty to make a new call for the amount still owing on the shares and to compel the vendee to pay the same.⁸ Moreover, under regulations which provide that the former owner of forfeited shares shall pay all calls that were due at the time of forfeiture, the reissue of forfeited shares with

¹ *Ladies Dress Ass'n v. Pulbrook* (1900), 2 Q. B. 376.

² *Mitchell v. Rome R. R. Co.*, 17 Ga. 574.

³ *Edinburgh, etc. Ry. Co. v. Hebblewhite*, 6 M. & W. 707.

⁴ *Bridgers and Neill's Case*, 4 Ch. 266.

⁵ *Creyke's Case*, 5 Ch. 63.

⁶ *Merrimac Mining Co. v. Bagley*, 14 Mich. 501.

Ramwell's Case, 50 L. J. Ch.

827; *Morrison v. Trustees, etc. Corp.*, 79 L. T. 605.

But see *Randt Gold Mining Co. v. New Balkis Eerstelling*, 85 L. T. 780; (1903), 1 K. B. 461, affirmed, (1904) A. C. 165.

⁸ *New Balkis Eerstelling v. Randt Gold Mining Co.* (1904), A. C. 165 (headnote inadequate).

Cf. *Moore v. Wheal Byjerkerno Tin Mining Co.* 17 Vict. L. R. 680..

a proviso that the new holder shall be subject to no liability thereon nevertheless leaves the amount of the previous calls due and payable "in respect of" the shares, so that the new holder is debarred from voting by a regulation that "no member shall be entitled to vote . . . whilst any sum shall be due and payable to the company in respect of any of the shares of such member."¹ Conversely, any sum which the former owner of forfeited shares is required to pay, after the forfeiture, under the company's regulations, is deemed to be payable in respect of the shares and therefore goes in reduction of the liability of the person to whom the shares are reissued.² Sometimes a sale of forfeited shares is made compulsory.³ A statutory provision for a sale of paid-up shares in the event of non-payment of certain assessments does not necessarily mean that the shares shall be forfeited or deprive the former owner of the proceeds of sale.⁴

§ 830. **Cancellation of Forfeiture.** — Inasmuch as forfeited shares may be reissued, it is competent to the company with the consent of the former holder to cancel the forfeiture:⁵ such cancellation amounts merely to a reissue of the shares of the former owner. But after the company has gone into liquidation, the forfeiture cannot be cancelled even with the consent of both the liquidator and the shareholder.⁶ Moreover, a power vested in the company to cancel a forfeiture without the consent of the former shareholder, who in consequence of a completed forfeiture has ceased to be a member of the company, would be so very extraordinary that it cannot be reserved to the company without the clearest language. For example, a provision in a company's regulations that the directors may "annul" a forfeiture upon such conditions as they see fit will not authorize them to cancel a completed forfeiture without the consent of the former holder of the shares.⁷

§ 831. **Effect of Forfeiture on Agent's Right to Commissions for procuring Subscriptions.** — Where an agent procures subscriptions to the company's shares under a contract by which he is to be paid a commission as the subscriptions are paid in, the effect

¹ *Randt Gold Mining Co. v. Bank of Ambia*, 86 Fed. 863; 30 *Wainwright* (1901), 1 Ch. 184. C. C. A. 443.

² *Randt Gold Mining Co.* (1904), 2 Ch. 468.

⁵ Cf. *supra*, § 818.

⁶ *Dawes' Case*, 6 Eq. 232.

³ See *supra*, § 815.

⁷ *Larkworthy's Case* (1903), 1

⁴ *Chicago Title, etc. Co. v. State* Ch. 711.

of a forfeiture of the shares for non-payment is to prevent the subscription from being paid and therefore to prevent the agent's right to commissions from accruing.¹ The court in the case last cited suggested, however, that the agent might have some remedy to compel the company either to sell the forfeited shares (in which case it seems to have been thought that the agent would be entitled to a commission on the amount realized) or to remit the forfeiture and sue for the amount due on the subscription.²

¹ *Maryland Agricultural College v. Baltimore, etc. R. R. Co.*, 43 Md. 434.

² *Maryland Agricultural College v. Baltimore, etc. R. R. Co.*, 43 Md. 434, 439.

CHAPTER XV

TRANSFER AND TRANSMISSION OF SHARES

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§ 832. **Transferability of Shares.** — Shares in incorporated companies are, at common law as well as under modern incorporation acts, freely transferable, notwithstanding the fact that

they are choses in action, and therefore belong to a class of property which was generally inalienable at common law. In other words, shares of capital stock constitute an exception to the rule that choses in action are not transferable at common law. A statute authorizing corporations to "render the interest of the stockholders transferable" will not be construed to abrogate this common-law rule so as to make the stock non-transferable unless the company adopts an enabling regulation.¹

The right of transfer is absolute and unfettered (provided any reasonable formalities required by the company be observed) except in so far as it may be cut down or qualified by statute or by the company's internal regulations. In England, the validity of regulations, or articles of association, restricting the shareholder's otherwise unfettered right of transfer has been expressly adjudged in spite of objections founded upon the rule against perpetuities and upon the principle of public policy which invalidates restrictions on alienation and agreements in restraint of trade and commerce.² In many of the United States, on the other hand, by-laws restricting the freedom of alienation, as distinguished from by-laws which merely regulate, in a reasonable way, the mode of alienation, are deemed contrary to public policy, and are held void.³ In those states, therefore, no restrictions upon the right of alienating shares of capital stock which transcend the limits of reasonable regulation are valid unless affirmatively authorized by some statute.

§ 833. **Definition of Complete Transfer of Shares — Transfer of Legal Title.** — A completed transfer of a share invests the transferee with all the rights and obligations incident to ownership previously enjoyed and borne by the transferor. The transfer is complete when, and not before, the transferee attains the status of shareholder not merely with respect to the transferor but also with respect to the corporation. The legal title to the shares may then be said to pass.⁴ The most instructive analogy

¹ *Miller v. Farmers' Milling, etc. Co.* (Nebr.), 110 N. W. 995.

² *Borland's Trustee v. Steel Bros. & Co.* (1901), 1 Ch. 279.

Accord: *Attorney-General v. Jameson* (1904), 2 Ir. 644.

³ *Supra*, § 706 et seq.

⁴ *Nanney v. Morgan*, 37 Ch. D.

346; *Fisher v. Essex Bank*, 5 Gray (Mass.) 373, 378, where Shaw, C. J., said, "When a transfer is rightfully made and completed, it vests a right in the transferee, not merely to act in the place of the vendor and in his name, but substitutes him, in all respects, as the legal and only

is furnished by the case of an assignment of a term for years in real estate. The legal title to the term passes when the assignee not merely acquires the rights and undergoes the liabilities of a tenant as between himself and the assignor but actually assumes the relation of tenant with respect to the lessor, all legal formalities — the execution and acknowledgment of a deed, recording, attornment, and the like — having been complied with. The corporation with respect to an assignment of shares occupies a position analogous to that of a lessor with respect to an assignment of the term.

§ 834. *Transfer of Possession as Step in Transfer of Title to Shares.* — Transfer of possession plays an important part in the transfer of title to personal property in general. Shares, being choses in action and therefore intangible property, cannot be said, if the proprieties of language be observed, to be capable of possession. For some purposes, however, connected with our present subject, shares may be possessed constructively or in law. For instance, an hypothecation of shares by a transfer endorsed upon the share-certificate has often been said by American judges to clothe the creditor with possession of the shares within the meaning of the law of pledges. So, where a married woman is the owner of shares, an exercise of ownership by the husband by executing a transfer thereof will be deemed a reduction to possession sufficient to vest the husband at common law with the absolute title, although the shares are never registered in his name on the company's books.¹

§ 835. *Transfer as distinguished from Transmission — From Sales.* — Transfers should be distinguished from transmission of shares. Transfer implies a voluntary passing of title from the

holder of the shares transferred, to the same extent to which they were before held by the vendor. The title, therefore, by which such interest is held, is strictly a legal title."

¹ *Johnson v. Hume*, 138 Ala. 564; 36 So. 421.

But see *Slaymaker v. Bank of Gettysburg*, 10 Pa. St. 373.

Cf. *Burr v. Sherwood*, 3 Bradf. (N. Y.) 85, 89 (receipt of dividends by the husband "only reduced the dividends into possession and not the stock"); *Brown v. Bokee*, 53

Md. 155 (city stock not reduced to possession by husband by receiving dividends and demanding that the stock be registered in his name, which demand the city refused to comply with unless the husband would attend at the registration office in person); *Arnold v. Ruggles*, 1 R. I. 165 (where the court in holding that shares had not been reduced to possession by the husband emphasized the fact that they had not been transferred to his name).

transferor to the transferee. Transmission, on the other hand, is properly applied to a devolution of title by operation of law — for example, by death, marriage, or bankruptcy.¹ A transfer must not be confused with a sale. Thus, an assignment of shares to the assignor's sister in consideration of a nominal sum and of love and affection, although not a sale, is a transfer as distinguished from a transmission of the shares.² So, an assignment to the equitable owner from a bare trustee, in whose name the shares have been put for convenience, is not a sale,³ but it clearly is a transfer.

§ 836. **Partial Transfers of Shares.** — As already stated, a complete and perfect transfer involves an assignment of all the transferor's rights of ownership. There may, of course, be partial transfers conveying some only of those rights;⁴ but such partial transfers can operate only in equity, and do not amount to a conveyance of the legal title to the shares. For example, the right to dividends is one of the most important rights incident to the ownership of shares, yet an assignment by a shareholder of his right to receive dividends would not amount to a transfer of the legal title to the shares, and would at most constitute the assignor a trustee for the assignee.⁵ The same thing is true, speaking generally, of each of the other rights which are incident to ownership of shares of stock, such, for example, as the right to vote. A transfer of the share — that is, a transfer of the legal title to the share — takes place, as stated above, when *all* the rights and liabilities of a shareholder are shifted upon the transferee and when he is substituted as a shareholder in the place of the transferor in the eyes of all the world, and particularly in the eyes of the corporation. •

¹ *Barton v. London, etc. Ry. Co.*, Div. 575; 69 N. Y. Supp. 142; 24 Q. B. D. 77, 88; *Bentham Mills State ex rel. Tozer v. Probate Court Co.*, 11 Ch. D. 900. (Minn.), 113 N. W. 888. As to executory limitations of shares, see *infra*, § 1009-§ 1011.

² *Copeland v. North Eastern Ry. Co.*, 6 E. & B. 277.

³ *Victor G. Bloede Co. v. Bloede*, 84 Md. 129; 34 Atl. 1127; 57 Am. St. Rep. 373; 33 L. R. A. 107.

⁴ *Re Brandreth*, 58 N. Y. App. N. E. 817.

⁵ Cf. *Re Brandreth*, 58 N. Y. App. Div. 575; 69 N. Y. Supp. 142. *Mortimer v. Potter*, 213 Ill. 178; 72

§ 837-§ 845. OF THE DOCTRINE THAT NEITHER SHARES NOR SHARE-CERTIFICATES ARE NEGOTIABLE.

§ 837-§ 842. *What Negotiability is.*

§ 837. **The two Elements of Negotiability.** — The books often state that although shares are transferable, yet neither the shares themselves nor the certificates which represent them are negotiable.¹ Such statements are likely to prove misleading unless the nature of negotiability be first clearly apprehended. Negotiability is an attribute of certain choses in action and consists of two parts or elements — first, an exception to the rule that choses in action are non-assignable, and, second, an exception to the rule that a transferor of personal property can pass to an assignee no greater legal title than he himself possesses. The former element or feature of negotiability is common to all negotiable instruments, while the latter is confined to instruments which either by their original tenor or by endorsement in blank are payable to bearer.

§ 838. **Negotiability as an Exception to the Rule that Legal Title to Choses in Action is not transferable — Rights of Bona Fide Endorsee for Value.** — The fact that a *bona fide* endorsee for value takes commercial paper free of any equitable defences in favor of prior parties can readily be demonstrated to be due to the first element of negotiability — that is, to be a mere corollary of the proposition that negotiable choses in action differ from other choses in action in being, like tangible property, freely transferable. The holder of legal title to an ordinary chattel, or other tangible property, subject to some trust or equity in favor of a third person can transfer the legal title discharged from the trust or equity by a sale to a *bona fide* purchaser for value. The reason that the same rule does not apply to the full extent to the owner of a non-negotiable chose in action is that, choses in action being non-assignable at common law, an attempted assignment does not confer legal title on the assignee but operates only as an irrevocable power of attorney to collect

¹ *Weaver v. Barden*, 49 N. Y. 286; *Am. Coal Co.*, 86 Iowa 436; 53 N. W. *Hammond v. Hastings*, 134 U. S. 401, 291; 17 L. R. A. 557. 404-405; 10 Sup. Ct. 727; *Clark v.*

any moneys payable in respect thereof, and necessarily therefore clothes the assignee or attorney with no greater rights against the debtor or obligor than the assignor or principal possessed, so that the assignee takes subject to all equities of the debtor or obligor, whether he had notice of them or not. As a transfer or endorsement of a negotiable chose in action does not operate as a power of attorney but as a transfer of legal title, an endorsee for value takes discharged from all equitable defences of prior parties of which he had no notice. This rule is, therefore, a mere consequence of the fact that negotiable choses in action are exempt from the common-law rule that choses in action are not assignable, and merely places negotiable choses in action on the same footing as tangible property.

§ 839. *Shares have this Element of Negotiability with its Consequences.* — Inasmuch as this important feature of negotiability is a mere consequence of the fact that negotiable choses in action are not assignable, it follows that the same consequences should attach to shares in incorporated companies, which are also exempt from the common-law rule of non-assignability. Such is, indeed, the law. For although shares of capital stock are not negotiable, yet being freely assignable they resemble in this respect negotiable choses in action and tangible property rather than other non-negotiable choses in action. In other words, a completed transfer of shares is a transfer of legal title, and as such, when made to a purchaser for value, cuts off all equitable rights in third persons¹ or in the company itself² of which the transferee had no notice.³

§ 840. **Negotiability as an Exception to the Rule that a Seller of personal Property can pass no better legal Title than he himself has — Rights of Purchaser from a Thief.** — The second and more peculiar element of negotiability consists in an exception to the rule that a possessor of personal property can pass to an assignee no better or greater title — that is, legal title — than he himself has. The only other exception, at common law, to this rule was in the case of a sale in market overt. The exception which we

¹ *Weaver v. Barden*, 49 N. Y. 286 (semble); *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30, 78-81. See *weight of American authority, a bona fide purchaser of shares acquires no right to maintain a shareholder's bill on account of transactions in which his assignor participated or acquiesced.* See *infra*, § 1169.

² See *infra*, § 883.

³ Note, however, that by the

are now considering, namely, the exception in the case of negotiable choses in action, applies only to instruments which are payable to bearer either by their original tenor or by virtue of an endorsement in blank. The possessor of a negotiable chose in action payable to order, unless he be the payee — that is to say, unless he be the holder of the legal title — can pass no greater title than he has. But in the case of bearer paper, the rule is different. If the instrument is stolen, the thief of course has no title either at law or in equity; but, nevertheless, he can pass an unimpeachable title to a *bona fide* purchaser.

§ 841. *Shares do not have this Element of Negotiability.* — Now, neither shares of stock nor share-certificates have this element of negotiability.¹ The shares themselves, being intangible, are not capable of manual possession or delivery, and cannot be stolen. An unauthorized entry of a transfer in the company's books may be deemed analogous to theft of tangible property; but it is well settled that such an entry passes no title and does not affect the rights of the true owner,² except that he may, if he so elect, treat the transaction as a conversion of the shares.³ In other words, a thief of shares — if a person who wrongfully procures himself to be registered as the owner of shares which belong to some one else may be so denominated — obtains no title and can pass none even to a *bona fide* purchaser. Under some circumstances the principle of estoppel may seem to bring about exceptions to this rule, which, however, are only apparent.

§ 842. *Share-Certificates do not, and cannot by Endorsement in Blank be made to have this Element of Negotiability.* — Share-certificates, likewise, are not payable to bearer, and cannot be made so payable by any endorsement thereon by the holder.⁴ Consequently, where share-certificates are stolen, the thief can pass no title even to a *bona fide* purchaser,⁵ unless indeed the circumstances are such that the true owner is estopped from

¹ *Weaver v. Barden*, 49 N. Y. 286. 7 Am. St. Rep. 73; 2 L. R. A. 836;

² See *infra*, § 936.

³ *Infra*, § 937, § 940.

⁴ *Colonial Bank v. Cady*, 15 A. C. Min. Co., 64 Cal. 388; 1 Pac. 349; 267 (headnote inadequate). See 49 Am. Rep. 705 (overruling *Winter v. Belmont Mfg. Co.*, 53 Cal. 428).

⁵ *East Birmingham Land Co. v. Dennis*, 85 Ala. 565; 5 So. 317; See *infra*, § 889.

setting up his title against the purchaser.¹ It has been held that any custom of stock brokers to treat share-certificates as negotiable instruments is unreasonable and void.² The true owner may require a *bona fide* purchaser of stolen share-certificates to return them, or if registered as shareholder to retransfer the shares; and the fact that a bank from whose custody the certificates were abstracted may be paying the expenses of the litigation does not affect the true owner's right to recover the shares.³ Any transferee of a stolen share-certificate is liable for a conversion of the shares, however innocently he may have acted; and the same is true of a broker through whose hands the certificate passes.⁴ On the other hand, the presumption is that the possessor of a share-certificate endorsed in blank is legally entitled thereto; and he will not be required to prove his title affirmatively by showing that the certificate was duly delivered by the endorser and that it came to his hands by a regular series of assignments without any break in the chain by theft or otherwise.⁵ Share-certificates not being negotiable, no dealing with the certificates can pass any greater rights to the shares than if the certificates, regarded as mere pieces of paper, — tangible personal property, — were the shares themselves.

§ 843. **Shares not within Rule that Transferee of Negotiable Instrument as Security for antecedent Debt deemed Holder for Value.** — An incident, or test, of negotiability in many jurisdictions is that although, in the case of property in general, one who takes the same as security for an antecedent debt is not deemed a purchaser for value, yet the rule is otherwise in the case of negotiable securities. Shares or share-certificates are not negotiable within the meaning of this rule; and hence a person who accepts share-certificates as security for a pre-existing debt is not deemed a holder for value.⁶

¹ See § 902, § 903.

² *East Birmingham Land Co. v. Dennis*, 85 Ala. 565; 5 So. 317; 7 Am. St. Rep. 73; 2 L. R. A. 836. ⁵ *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 616, 623-624; *Coffey v. Coffey*, 179 Ill. 283; 53 N. E. 590. Cf. *Plankinton v. Hildebrand*, 89

³ *O'Herron v. Gray*, 168 Mass. 573; 47 N. E. 429; 60 Am. St. Rep. 411; 40 L. R. A. 498. Wisc. 209; 61 N. W. 839. ⁶ *National, etc. Trust Co. v. Gray*, 12 D. C. App. Cas. 276. Cf. *Kisterbook's Appeal*, 127 Pa. St. 601; 18

⁴ *Bercich v. Marye*, 9 Nevada 312; *Swim v. Wilson*, 90 Cal. 126; 27 Pac. 33; 25 Am. St. Rep. 110; 13 L. R. A. 605. Atl. 381; 14 Am. St. Rep. 868; *Gurley v. Reed*, 190 Mass. 509, 512; 77 N. E. 642; and *infra*, § 913.

§ 844. **Shares so far Negotiable as to be Exempt from Doctrine of Lis Pendens.** — There is much doubt whether the doctrine of constructive notice by *lis pendens* applies to personal chattels or articles of commerce, and no doubt at all that it does not apply to negotiable paper. It does not apply to shares in the capital of incorporated companies.¹

§ 845. **Shares not within Doctrine of Dearle v. Hall.** — Negotiable instruments are not subject to the doctrine laid down in the leading case of *Dearle v. Hall*,² that of two adverse claimants to a chose in action other than the original creditor or obligee he who first gives notice of his claim to the debtor or obligor will prevail. This doctrine as applied to non-negotiable choses in action is accepted in England and in some of the United States; but there is much doubt whether it applies to transfers of legal title to shares in incorporated companies. The whole doctrine rests, perhaps, upon no very satisfactory ground; and even if it is to be accepted at all it should not be extended to choses in action of such a very peculiar kind as shares.³ Indeed, the doctrine is purely an equitable one, whereas transfers of shares are transfers at law as well as in equity.

§ 846–§ 880. *MODE OF EFFECTING A TRANSFER OF SHARES.*

§ 846. **Nature of Subject — Comparison with Conveyancing.** — That branch of the law which treats of the methods by which the transfer of shares is effected is a topic which might appropriately be called corporate conveyancing. Just as the science of conveyancing treats of the manner in which a transfer of title

¹ *Holbrook v. New Jersey Zinc Co.*, (headnote inadequate); *Houser v. 57 N. Y. 616*; *Davis v. Miller Signal Richardson*, 90 Mo. App. 134.
Co., 105 Ill. App. 657; *American* Note, however, that transfers of
Press Ass'n v. Brantingham, 75 N. Y. equitable interests in shares may be
 App. Div. 435; 78 N. Y. Supp. 305. subject to the rule in *Dearle v. Hall*,

But see *Dana v. Brown*, 1 J. J. so that the transferee who first
 Marsh. (Ky.), 304, 306. notifies the trustee of his claim may
 have prior right. Cf. *Houser v.*

² *Dearle v. Hall*, 3 Russ. 1.

³ Cf. *Pitot v. Johnson*, 33 La. Ann. *Richardson*, 90 Mo. App. 134; *Holt*
 1286; *Continental Nat. Bank v. v. Dewell*, 4 Hare 446 (a case relating
Eliot Nat. Bank, 7 Fed. 369, 375–376 to an interest in British consols or
 (headnote inadequate); *Cornick v. government stock*). See also *infra*,
Richards, 3 Lea (Tenn.) 1, 16–22 § 993.

to real estate is effected, so the subject which we are now considering relates to the modes by which a transfer of title to shares is accomplished.

§ 847. **Transfer by formal Deed of Assignment.** — In England, the instrument of transfer is often if not usually a formal deed of assignment. This deed is a formal instrument, entirely separate from the share-certificate. When the deed of transfer is presented to the company for registration on its books, the transferor's certificate is regularly and usually surrendered to the company; but the deed is not endorsed upon the certificate or physically connected with it. Such a deed of transfer is subject to all the technical rules of the common law applicable to other deeds. For instance, authority to fill up a material blank left in the instrument when sealed and delivered can only be conferred by a power of attorney under seal;¹ and consequently a deed of transfer containing a material blank — for example, a blank for the name of the transferee — cannot pass legal title to the shares.² Some diversity of opinion has existed among English judges whether the transfer could be validated by estoppel in favor of a *bona fide* purchaser to whom the transferee after filling up the blanks may have sold the shares.³ Of course, if the deed is redelivered by the transferor after the blanks have been filled up, then upon familiar principles the instrument is valid.⁴

§ 848-§ 851. *Transfer by Writing not under Seal.*

§ 848. **In general.** — These technical rules of law respecting deeds of transfer seriously interfere with the free alienation of shares which is so important in modern commercial or financial

¹ *Hibblewhite v. McMorine*, 6 Wend. (N. Y.) 348, 364-366; 34 M. & W. 200. Am. Dec. 317.

² *Powell v. London & Provincial Bank* (1893), 2 Ch. 555; *Colonial Bank v. Whinney*, 11 A. C. 426; *Société Générale de Paris v. Walker*, 11 A. C. 20; *Hibblewhite v. McMorine*, 6 M. & W. 200; *Swan v. North British Australasian Co.*, 2 H. & C. 175. ³ See *Ex parte Swan*, 7 C. B., N. S., 400; *Swan v. North British Australasian Co.*, 7 H. & N. 603 (affirmed on other grounds, 2 H. & C. 175); *Taylor v. Great Indian Peninsula Ry. Co.*, 4 De G. & J. 559. Cf. *Bridgeport Bank v. New York, etc. R. R. Co.*, 30 Conn. 231.

But see *Bridgeport Bank v. New York, etc. R. R. Co.*, 30 Conn. 231; *Commercial Bank v. Kortright*, 22 ⁴ Cf. *Société Générale de Paris v. Walker*, 11 A. C. 20.

transactions, and particularly with the convenient practice of executing transfers with a blank for the name of the transferee. The English as well as the American courts have therefore fortunately held that whilst, particularly in the early days of modern incorporated joint-stock companies, a deed of transfer was regarded as the normal method of alienation, yet a transfer by simple instrument in writing not under seal is quite effective,¹ unless the company's regulations require a deed,² even though the practice in the company has been to insist upon a deed.³ The rigid common-law rules as to deeds are thus escaped.

§ 849. **Disadvantages of separating the written Transfer from the Share-Certificate.** — Whilst this modern English method of transferring shares by a writing under the hand but not under the seal of the transferor is much more flexible than the older method of transfer by deed, yet, inasmuch as the transfer is upon a separate sheet of paper from the share-certificate, there is always danger of inconvenience in case the two instruments come into different hands. The possibilities of fraud are thus increased; and the English books contain a number of cases dealing with the relative rights of a transferee claiming under such a transfer and a person who without knowledge of the former's rights has got possession of the share-certificate — for example, as collateral security for a loan. Moreover, there is always the possibility that the shares may be misdescribed in the transfer, either accidentally or by fraudulent design; and in such cases hardship to innocent persons is not unlikely to result. These drawbacks seem to be inseparable from the English custom of having the transfer upon a separate piece of paper from the share-certificate, whether the transfer be under seal or not.

§ 850. **American Practice of endorsing Transfer on Share-Certificate.** — In America, all the disadvantages referred to in the last paragraph have been obviated by the simple expedient of endorsing the transfer upon the back of the share-certificate,

¹ *Ex parte Sargent*, 17 Eq. 273; *man v. Henderson*, 1 Tenn. Ch. App. *Atkinson v. Atkinson*, 8 Allen (Mass.) 749.

15. Cf. *Fox v. Martin*, 64 L. J. Ch. 473; *Ortegosa v. Brown*, 38 L. T. 145.

As to an oral transfer, see *Love-*

² See *infra*, § 946.

³ *Ex parte Sargent*, 17 Eq. 273.

which usually bears a printed form of transfer to be filled out and signed by the transferor. The endorsed transfer is rarely under seal, and therefore all technicalities of the common law respecting specialties are avoided. Moreover, as the transfer usually covers the shares which are represented by the certificate, and no others, there is no possibility of trouble arising from a misdescription of the shares intended to be transferred, either by misstating their number or the name of the company. Finally, the transfer being inseparable from the certificate, no question can come up as to the conflicting rights of the holder of the certificate and the holder of the transfer. This last advantage of the American system was mentioned and recognized by Lord Watson in the House of Lords;¹ but nevertheless the American method does not seem to have been adopted by any English companies.

§ 851. **Same Principles applicable whether Transfer separate from Share-Certificate or endorsed thereon.** — Transfers of shares are governed by the same principles whether, as in England, they are separate and distinct from the share-certificate or whether, as usually in the United States, they are endorsed upon it.² Indeed, a transfer of shares in an English company endorsed upon the certificate would be quite as valid as if it were written upon a separate paper; and, conversely, in America, a transfer disconnected from the certificate has the same effect as if endorsed upon it.³ The American practice is one of convenience merely. The American system tends, however, to emphasize more than the English system the importance of the share-certificate, and naturally produces the impression among

¹ *Colonial Bank v. Cady*, 15 A. C. 267, 275. Said the learned lord: "The system thus adopted" — that is, the ordinary American system of transfers endorsed upon the share-certificates — "has the merit of inseparably connecting the certificate with the transfer, and so preventing the dishonest creation of a legal right by transfer to one person, and a competing equitable right by deposit of the certificate with another."

² See *Colonial Bank v. Cady*, 15 A. C. 267 (headnote inadequate).

³ *Smith v. Savin*, 141 N. Y. 315; 36 N. E. 338; *De Caumont v. Bogert*, 36 Hun (N. Y.) 382; *Mahaney v. Walsh*, 16 N. Y. App. Div. 601; 44 N. Y. Supp. 969; *Lipscomb v. Condon*, 56 W. Va. 416; 49 S. E. 392; 107 Am. St. Rep. 938; 67 L. R. A. 670 (where no certificate had been issued); *Richardson v. Longmont Supply Ditch Co.*, 19 Colo. App. 483; 76 Pac. 546.

But see *Tafft v. Presidio, etc. R. R. Co.*, 84 Cal. 131; 24 Pac. 436; 11 L. R. A. 125; 18 Am. St. Rep. 166.

business men that the certificate actually is the shares instead of being merely convenient evidence of ownership of shares.

§ 852. **Transfer by mere Delivery of Certificate — "Share Warrants."** — Apart from express statutory authority, a corporation has no power to create shares which shall be transferable merely by delivery — in other words, to issue certificates certifying the bearer to be the holder of the shares represented thereby.¹ To do so is impliedly prohibited by statutory provisions requiring the company to keep a register of shareholders — a provision which could not be complied with if shares were made transferable by mere delivery of the certificate. To be sure, in America, after a certificate is endorsed in blank, it passes from hand to hand much in the same way as commercial paper payable to bearer; but whilst in this way as between successive holders of the certificate, title to the shares passes by mere delivery, yet the legal title — the only title which the company is bound to recognize — remains in the registered holder. It is this legal title — the title as against the company — which cannot be made transferable by mere delivery of the certificates.² Moreover, as stated above, transfer of a certificate even when endorsed in blank passes no greater title to the shares than if the paper on which the certificate is printed, regarded as a mere chattel, were the shares themselves which are represented thereby; and consequently a *bona fide* purchaser of the endorsed certificate from a thief does not acquire a better title than the thief, as he would do if the certificates were negotiable by delivery.

¹ *Reuss v. Bos*, L. R. 5 H. L. 176, 191–192, 200; *McEwen v. London Wharves Co.*, 6 Ch. 655.

² "Except under the provisions of the Companies Act, 1867, which authorize the issue of share warrants to bearer in the case of shares or stock fully paid-up, shares transferable to bearer can hardly exist; for they are not consistent with the statutory enactments relating to registers. But regulations might be made to the effect that share certificates should be transferable to bearer; and that the bearer should be entitled to be registered; but that the persons on the register should alone be members of the company. Such certificates or the share warrants above referred to might then become negotiable by usage." 1 Lindley on Companies, 6th ed., 656–657. Cf. *Rumball v. Metropolitan Bank*, 2 Q. B. D. 194, and *infra*, § 860.

In England, however, the Companies Act of 1867 expressly empowers companies limited by shares organized under the Companies Acts to issue, for fully paid shares, certificates — called share warrants — stating that the bearer of the warrant is entitled to the share or shares therein specified.¹ Similar provisions are found in some other British statutes. By virtue of these enactments, companies may make their shares transferable by mere delivery of the certificate from hand to hand, just as bonds or debentures payable to bearer are transferred, without the necessity of registration. Such certificates or share warrants are negotiable in the fullest sense of the word, and if lost or stolen, a *bona fide* purchaser from the thief gets a good title.² In view of the popularity in the United States of securities such as corporation bonds, which are transferable by delivery, and ownership of which cannot easily be traced by tax collectors or other inquisitive persons, one might not be surprised if some state legislatures should authorize the issue of securities like these English share warrants; but no such law is known to be on the statute books of any state at the present time.

§ 853-§ 866. TRANSFER ON THE COMPANY'S BOOKS —
REGISTRATION OF TRANSFER.

§ 853. **Transfer by mere Entry on the Company's Books.** — In view of the principles which are stated below as to the function in corporate conveyancing of the company's share register, the simplest method of effecting a transfer of shares might be thought to be by a mere entry in the books of the company without the execution of any previous transfer. There is no reason to doubt that such an entry, made by the authority of the transferor, although without any writing signed by him or by any one as his agent, would constitute a valid transfer.³

¹ 30 & 31 Vict., c. 131, § 27 *Oriental Mills*, 17 R. I. 551; 23 Atl. et seq. 795; *White v. Salisbury*, 33 Mo. 150.

² *Webb, Hale & Co. v. Alexandria Water Co.*, 93 L. T. 339, disposing of doubt expressed in *Simmons v. London Joint Stock Bank* (1891), 1 Ch. 270, 296. See infra, § 868, as to implied transfers, and infra, § 970. Cf. *First Nat. Bank v. Gifford*, 47 Iowa 575; *Haynes v. Brown* (Okl.), 89 Pac. 1124 (where a statute providing that shares should be trans-

³ See *American Nat. Bank v.*

Even if, as in some of the American States, a contract for the sale of shares be deemed to be within the Statute of Frauds, yet an actual transfer on the books of the company even without any writing signed by the transferor would be effective; the Statute of Frauds applies only to contracts for sale of personal property and not to transfers¹ completed by delivery, for which an entry in the company's books is in the case of shares of capital stock the only possible substitute or equivalent.

However, a transfer by a mere entry in the books, though legally possible, is inconvenient and consequently rare in practice. In the first place, the very important fact of the transferor's assent to the transfer is left to be proved by parol, so that if at any time the transferor or his representative should deny that the entry in the books was authorized by him, the company, in order to exculpate itself, would be subject to the burden of establishing such authority by parol proof,² which in convincing form might not be readily forthcoming. Secondly, unless the transferor surrendered his share-certificate, he would still retain the indicia of title so that, as will presently be more fully explained, the company might incur serious liability to persons who might deal with him on the faith of the certificate.³ A transfer by *mere* entry in the company's books is therefore rarely resorted to.

§ 854. **Entry of Transfer on Books ineffective unless made by Authority of former Owner.** — Of course, a transfer on the company's books is void, at law and in equity, unless the entry upon the books is made in pursuance of authority from the transferor. A transfer, though registered with all possible formalities, is ineffective unless made by the authority of the supposed transferor.⁴ If for any reason the entry is made with-

ferable on delivery of certificate and registration on the company's books was thought to render invalid a transfer on the books without delivery of the certificate); *First Nat. Bank v. Stribling*, 16 Okl. 41; 86 Pac. 512. See also *Newell v. Williston*, 138 Mass. 240, 243 (where it was said *obiter* that registration would not be effective unless there is a prior complete transfer); *Richardson v. Emmett*, 61 N. Y. App.

Div. 205; 70 N. Y. Supp. 546 (holding a gift of shares effectuated by mere entry in the company's books to be incomplete).

¹ Cf. *French v. White* (Vt.), 62 Atl. 35 (where statute requiring a transfer to be by "assignment" was held to necessitate a written transfer).

² See *infra*, § 936, § 937.

³ See *infra*, § 910.

⁴ *France v. Clark*, 26 Ch. D. 257.

out his authority — for example, if the transferor's signature to the transfer is a forgery — the registration confers no title whatsoever upon the transferee.¹ This doubtless is all that is meant by the dictum of a learned judge that registration of the name of a transferee is effective only in the case of a prior valid transfer.² Moreover, registration of a transfer cannot confer title unless the transferor had the title to convey.³ The transferee in any of these cases may, however, have valuable rights by estoppel.⁴

§ 855-§ 863. *Necessity for completing written Transfer by Entry or Registration on the Company's Books.*

§ 855. **In general.** — The formal instrument of transfer of shares, whether it be under seal or not, and whether it be separate from the certificate or endorsed thereon, should as a practical matter always be followed by entry of the transfer in the company's books. It is submitted that such an entry or registration of the transfer is required by law. The consideration of this question involves a brief digression into the law respecting the nature and function, in general, of the company's share register or stock book.

§ 856. **Function of Company's Register of Shareholders in determining the Persons who are to be officially recognized as Shareholders.** — Often, either by statute or under by-laws, the shares are expressly made transferable only upon the books of the company. Even where no such express declaration exists, some statutory provision, either express or implied, requiring the company to keep a share register or stock book, is usually to be found; and wherever a register of shareholders is to be kept, its very object and purpose is to enable the company to know who are its members and to act accordingly. Hence, the corporation should always be protected in treating the registered shareholder as the legal owner, either by paying him dividends,⁵

Cf. *May v. Genesee County Savings Bank*, 120 Mich. 330; 79 N. W. 630. 263. Cf. *Newell v. Williston*, 138 Mass. 240, 243.

¹ See *infra*, § 904, as to forged transfers, and § 880, as to transfers by persons under disability.

² *France v. Clark*, 26 Ch. D. 257,

³ *France v. Clark*, 26 Ch. D. 257.

⁴ See *infra*, § 890-§ 923.

⁵ See *infra*, § 1369.

As to dividends in liquidation,

receiving his vote at a general meeting,¹ or otherwise.² Moreover, the registered holder of shares is usually the person who is subject to the liabilities of a shareholder in respect thereof.³

§ 857. **Registered Shareholders as Holders of Legal Title.** — Indeed, the generalization may be deduced that the person who is registered as the owner of shares is to be deemed the holder of the legal title: the company's books as a rule determine the legal title to its shares. To this principle there is one important exception, namely, cases in which the registry is erroneous owing to the company's own fault⁴ — for example, where the company wrongfully neglects to register a transfer which is duly presented for registration.⁵ Of course, a shareholder whose name is stricken from the books, whether by accident or design, without his authority, does not lose his shares, and, conversely, a person whose name is inserted on the register without his consent does not become liable as a shareholder.⁶ But in all ordinary cases ownership of shares does not amount to complete legal ownership unless the owner's name be entered on the company's books. Persons other than the registered holder can in general have no greater rights than those of *cestuis que trust* or equitable, as distinguished from legal, owners.

§ 858. **Doctrine that Transfer not complete until registered.** — No transfer, therefore, can well be deemed fully and in all respects consummated until the transferee's name is entered as a shareholder in the company's books in the room of the transferor.⁷ *A fortiori*, a transfer is incomplete until entered on the company's books, where a statute provides that shares shall be transferable only on the books of the corporation *in such manner*

see *Bath Savings Institution v. Sagadahoc*, 89 Me. 500; 36 Atl. 996.

¹ See *infra*, § 1220.

² Cf. *Pray v. Todd*, 71 N. Y. App. Div. 391; 75 N. Y. Supp. 947; *Hollister v. De Forest Wireless Tel. Co.*, 47 N. Y. Misc. 674 (headnote inadequate); 94 N. Y. Supp. 504 (corporation not bound to allow unregistered transferee of shares to inspect its books).

But see *Sylvania, etc. Co. v. Hoge* (Ga.), 59 S. E. 806.

³ See *supra*, § 764.

⁴ See *infra*, § 1221.

⁵ See *infra*, § 861.

⁶ *Welch v. Gillelen*, 82 Pac. 248; 147 Cal. 571.

⁷ *McMurrich v. Bond Head Harbour Co.*, 9 Up. Can. Q. B. 333.

But see *Sayles v. Bates*, 15 R. I. 342, 346; 5 Atl. 497; *Dain Mfg. Co. v. Trumbull Seed Co.*, 95 Mo. App. 144; 68 S. W. 951; *Crawford v. Provincial Ins. Co.*, 8 Up. Can. C. P. 263 (where the court refused a mandamus to compel registration of a transfer, on the ground that registration was unnecessary).

as the by-laws may prescribe but where no by-laws are adopted on the subject.¹ A provision in the share-certificate requiring transfers to be registered would seem to have the same effect as a duly adopted by-law.² Some statutes go so far as to enact that no transfer which is not promptly registered on the company's books shall be valid "for any purpose" except to render the transferee liable for the company's debts.³

§ 859. **Answer to Argument that Registration not necessary unless affirmatively required by Statute or By-law.** — To be sure, the position is taken by some authorities that, at common law and apart from any by-laws or regulations on the subject, the formality of registration on the company's books should not be required in the case of a transfer of shares any more than in the case of a transfer of other personal property; but this reasoning overlooks the fact that shares belong to a class of property, namely, choses in action, which is not assignable at common law. Hence, there is, on principle, nothing to prevent a court from taking the position that the same policy which justifies in the case of shares an exception to the rule of the non-assignability of choses in action also requires that a transfer of this exceptional class of property should not be deemed complete at law until entered on the company's books. That position is strongly reinforced by considerations of practical convenience. At any rate, some notice of the transfer should be brought home to the company before the novation, or substitution of the transferee in place of the transferor, is fully and legally consummated.

§ 860. **Whether Delivery of Certificate endorsed with Transfer passes Legal Title.** — Many American authorities declare that, even where by statute or by-law shares are transferable only upon the company's books, nevertheless the delivery of the share-certificate endorsed in the ordinary way will pass legal title as between the parties.⁴ It has remained for a member

¹ *Plumb v. Bank of Enterprise*, 48 Kans. 484; 29 Pac. 699.

But see *Allen v. Stewart*, 7 Del. Ch. 287, 297; 44 Atl. 786.

As to failure to adopt by-laws on the subject of transfers, see further *American Nat. Bank v. Oriental Mills*, 17 R. I. 551; 23 Atl. 795.

² *Williams v. Mechanics' Bank*, 5 Blatchf. 59.

³ *Pueblo Sav. Bank v. Richardson* (Colo.), 89 Pac. 799.

⁴ *Carroll v. Mullanphy Savings Bank*, 8 Mo. App. 249; *Joslyn v. St. Paul Distilling Co.*, 44 Minn. 183; 46 N. W. 337 (semble); *Leitch v.*

of the House of Lords in a case relating to a transfer of American railway shares to explain what is really meant by such a statement and to point out that in the bald form above given it is inaccurate and capable of misconstruction. "Delivery," said Lord Watson, referring to a delivery of the certificate coupled with an endorsed transfer in blank, "does not invest him" — i. e., the transferee — "with the ownership of the shares in the sense that no further act is required to perfect his right. Notwithstanding his having parted with the certificate and transfer, the original transferor, who is entered as owner in the certificate and register, continues to be the only shareholder recognized by the company as entitled to vote and draw dividends in respect of the shares, until the transferee or holder for the time being obtains registration in his own name. *It would, therefore, be more accurate to say that such delivery passes, not the property of the shares, but a title, legal and equitable, which will enable the holder to vest himself with the shares without risk of his right being defeated by any other person deriving title from the registered owner.*"¹ In order that delivery of the certificate coupled with the endorsed transfer should have this effect, the delivery must have been with intent to pass title, unless the registered owner is estopped from denying such intent, a matter which will be considered below. Some American authorities state that delivery of the certificate with the endorsed transfer confers only an equitable right;² but whilst such delivery may

Wells, 48 N. Y. 585; *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325, 331; 7 Am. Rep. 341; *Commercial Bank v. Kortright*, 22 Wend. (N. Y.) 348; 34 Am. Dec. 317; *Parker v. Bethel Hotel Co.*, 96 Tenn. 252; 34 S. W. 209; 31 L. R. A. 706; *Hubbard v. Bank of U. S.*, 12 Fed. Cas. 777; *Cherry v. Frost*, 7 Lea (Tenn.) 1.

Cf. *Johnston v. Laflin*, 103 U. S. 800; *Bank of Commerce v. Bank of Newport*, 63 Fed. 898; 11 C. C. A. 484; *Butler v. Montgomery Grain Co.*, 85 Mo. App. 50; *Mahaney v. Walsh*, 16 N. Y. App. Div. 601; 44 N. Y. Supp. 969 (holding that a transferee claiming under a written transfer not endorsed on the share-

certificate and never registered might maintain trover against the transferor for executing a second transfer to somebody else).

¹ *Colonial Bank v. Cady*, 15 A. C. 267, 277-278.

² *Fisher v. Essex Bank*, 5 Gray (Mass.) 373; *Bercich v. Marye*, 9 Nevada 312, 316; *Lippitt v. American Wood Paper Co.*, 15 R. I. 141; 23 Atl. 111; 2 Am. St. Rep. 886; *Noble v. Turner*, 69 Md. 519; 16 Atl. 124; *Baltimore Retort, etc. Co. v. Mali*, 65 Md. 93; 3 Atl. 286; 57 Am. St. Rep. 304; *Bank of Commerce's Appeal*, 73 Pa. St. 59; *Taliferro v. First Nat. Bank*, 71 Md. 200, 214.

transfer not endorsed on the share-

convey only equitable *title* to the shares, it does confer some legal as well as equitable rights. The passage quoted from Lord Watson's judgment in *Colonial Bank v. Cady* is believed to be a sound and accurate statement of the law. The conflict between the various authorities upon this point is largely a dispute about words.¹

The delivery of a certificate with a mere parol or oral transfer will have the same effect as if the transfer were on the certificate in the usual way,² except where by statute or the company's regulations transfers are required to be in writing or where the case is within the Statute of Frauds.

§ 861. **Passing of Legal Title without Registration where Failure to register is due to Company's Fault.** — Whilst registration of a valid transfer invests the transferee with the legal title, and whilst registration is in general indispensable in order to clothe the transferee with complete legal title, yet if a failure to register is due to the fault of the company, the transferee's rights and liabilities will be the same as if his name had been duly entered on the register. In other words, the legal title to shares passes as soon as an absolute right to immediate registration accrues and is wrongfully disregarded by the company.³

¹ "Such a title is sometimes called an equitable title with an irrevocable power to acquire the legal title, and sometimes a legal title as between the parties; but this is a question of the proper use of words." *Berne*, 95 N. Y. 637; *McLean v. Medicine Co.*, 96 Mich. 479; 56 N. W. 68; *Chemical Nat. Bank v. Colwell*, 132 N. Y. 250; 30 N. E. 644 (where the company kept no books); *Blooming Grove Cotton Oil Co. v. First Nat. Bank*, 56 S. W. Rep. 552 (Tex. Civ. App.); *Hunt v. Seeger*, 98 N. W. 91; 91 Minn. 264; *Earle v. Carson*, 188 U. S. 42; 23 Sup. Ct. 254; *Earle v. Coyle*, 97 Fed. 410; 38 C. C. A. 226; *Equitable Securities Co. v. Johnson* (Cal.), 85 Pac. 840 (headnote inadequate); *Hayes v. Shoemaker*, 39 Fed. 319.

² *Commonwealth v. Compton*, 137 Pa. St. 138; 20 Atl. 417; *Walsh v. Sexton*, 55 Barb. 251. See also *infra*, § 884.

But see *Matthews v. Hoagland*, 48 N. J. Eq. 455; 21 Atl. 1054.

³ *Nanney v. Morgan*, 37 Ch. D. 346, 354 (semble); *Moore v. North Western Bank* (1891), 2 Ch. 599;

Sargent v. Franklin Ins. Co., 8 Pick. (Mass.) 90; 19 Am. Dec. 306; *Chouteau Spring Co. v. Harris*, 20 Mo. 382; *Real Estate Trust Co. v. Bird*, 90 Md. 229; 44 Atl. 1048; *Robinson v. National Bank of New*

Where the transferee is also an officer of the company, delivery of the transfer to him as transferee and not as an officer of the corporation is not equivalent to requesting or demanding registration of the transfer by the company;¹ but the fact that the transferor is a director and charged with the duty of seeing that the books are properly kept does not prevent him from being discharged from all liability if the transfer is presented to the proper officer who states that nothing further need be done in order to consummate the transfer.² Of course, a transferee does not, within the meaning of this rule, have a right to immediate registration unless the transferor had a good title and duly authorized registration of the transfer,³ — in other words, unless the circumstances are such that an actual registration of the transfer would, according to the principles stated in the foregoing paragraphs, pass the legal title. And where the directors have a discretion to reject a transfer, a present absolute right to registration, sufficient to clothe the transferee with legal title, cannot be deemed to arise until the directors have considered and actually approved the transfer.⁴ In any case, a corporation is not bound to register a transfer until the transferor's share-certificate is surrendered or tendered;⁵ and therefore until such surrender or tender, a present absolute right to regis-

failure to register is due to company's own fault).

Cf. *Brown v. Adams*, 5 Biss. 181 (where the court seems not to have had in mind the rule of law stated in the text); *Isham v. Buckingham*, 49 N. Y. 216; *Plymouth Bank v. Bank of Norfolk*, 10 Pick. (Mass.) 454; *Ireland v. Hart* (1902), 1 Ch. 522; *Smith v. Bank of Nova Scotia*, 8 Can. Sup. Ct. 558 (where in an action for calls a plea on equitable grounds that defendant had transferred his shares by a transfer which the company had improperly refused to register was held good).

As to waiver of the requirement of registration by recognizing a transferee as shareholder, see *Upton v. Burnham*, 3 Biss. 431 (an action for calls); *Cutting v. Damerel*, 88 N. Y. 410; *Laing v. Burley*, 101 Ill. 591 (issue of certificate to transferee

equivalent to registration); *Stewart v. Walla Walla, etc. Pub. Co.*, 1 Wash. St. 521; 20 Pac. 605.

¹ *Richmond v. Irons*, 121 U. S. 27, 56-59; 7 Sup. Ct. 788.

Cf. *Earle v. Coyle*, 97 Fed. 410; 38 C. C. A. 226; *Hamilton v. Grant*, 30 Can. Sup. Ct. 566 (where the transferor was relieved from liability although the transfer had never been registered, on the ground that the transferee had acted as an officer, the transferred shares being necessary to qualify him), affirming 33 Nova Scotia 77.

² *Bracken v. Nicol* (Ky.), 99 S. W. 920.

³ *Fox v. Martin*, 64 L. J. Ch. 473.

⁴ *Moore v. North Western Bank* (1891), 2 Ch. 599.

Cf. *Roots v. Williamson*, 38 Ch. D. 485.

⁵ See *infra*, § 928.

tration does not accrue¹ nor does the legal title pass, unless indeed the certificate is satisfactorily proved to have been destroyed, and a sufficient bond of indemnity offered. Moreover, a corporation is not bound to register a transfer as soon as it is presented but may wait a reasonable time to examine into its genuineness and validity;² and until the lapse of such reasonable time the company is not in default and the legal title cannot be deemed to have passed. As the company has a right to close its books for a reasonable time before a shareholders' meeting,³ the company is not in default for refusing to register a transfer which is presented while the books are so closed.⁴ If by the company's regulations a fee be required for registration of a transfer, the company is not in default in failing to register a transfer unless the fee be paid or tendered.⁵ So, if the company is forbidden by the revenue laws from registering an unstamped transfer, the company is not in default unless a transfer presented for registration be duly stamped.⁶

§ 862. **Registration not necessary in order to pass Equitable Title.**—Registration is, of course, not necessary in order to give the transferee an equitable title. This is true even when a statute declares that no transfer shall be effectual, or that no transfer shall be effectual except as against the transferor or his administrators, unless registered on the company's books;⁷ and hence such a statute will not avail a subsequent transferee or lienor with actual notice of the prior unrecorded transfer.⁸

¹ *Société Générale de Paris v. Scherck v. Montgomery*, 33 So. 507; *Walker*, 11 A. C. 20.

² *Société Générale de Paris v. Walker*, 11 A. C. 20, 41. See *infra*, § 927.

³ *Infra*, § 925.

⁴ *Cook v. Carpenter* (Pa.), 61 Atl. 804; 212 Pa. 177.

⁵ *Giesen v. London, etc. Mge. Co.*, 102 Fed. 584 (headnote inadequate); 42 C. C. A. 515.

⁶ *Giesen v. London, etc. Mge. Co.*, 102 Fed. 584 (headnote inadequate); 42 C. C. A. 515.

⁷ *Black v. Zacharie*, 3 How. 483; *Kellog v. Stockwell*, 75 Ill. 68; *Johnson v. Underhill*, 52 N. Y. 203; *Shellington v. Howard*, 53 N. Y. 371;

81 Miss. 426.

Cf. *Pueblo Sav. Bank v. Richardson* (Colo.), 89 N. W. 799 (where a statute provided that no transfer should be valid "for any purpose" except to render the transferee liable as shareholder unless registered within sixty days).

⁸ *Hotchkiss v. Union Nat. Bank*, 68 Fed. 76; 15 C. C. A. 264; *Prince Investment Co. v. St. Paul, etc. Land Co.*, 68 Minn. 121; 70 N. W. 1079.

Cf. *Home Stock Ins. Co. v. Sherwood*, 72 Mo. 461 (headnote misleading).

But see *First Nat. Bank v. Hastings*, 7 Colo. App. 129; 42 Pac. 691.

§ 863. **Whether Registration necessary where Transferee bears same Name as Transferor.** — Where a transfer is made to a person of the same name as the transferor, although convenience certainly dictates that some note of the transfer should be made on the company's books, it seems that no entry on the register is necessary in order to vest the legal title in the transferee. Thus where shares standing in the name of a married woman passed on her death to the surviving husband by whom they were given to his second wife who bore precisely the same name as the former wife, it was held that, the company having notice of all the above-mentioned facts, the title of the second wife was complete without any entry on the books and without surrendering or changing the certificate issued to the first wife.¹

§ 864. **What is the proper Book for Registration of Transfers.** — In view of the importance of registration of transfers in the company's books, it is pertinent to inquire, first, what book or books should be deemed for these purposes the company's registration book, and secondly, what entries therein will be deemed sufficient. As to the first of these questions, it may be said that a very informal or irregular book will accomplish the purpose if no other book is kept.² Thus, the book containing the stubs of share-certificates may be a sufficient share register.³ "The account in a stock ledger, showing the names of the stockholders, the number and amount of the shares belonging to each, and the sources of their title, whether by original subscription and payment or by derivation from others, is quite suitable, and fully meets the requirements of the law."⁴ On the other hand,

¹ *Colton v. Williams*, 65 Ill. App. 466.

² *Stewart v. Walla Walla, etc. Pub. Co.*, 1 Wash. St. 521 (headnote inadequate); 20 Pac. 605.

As to the case where the company keeps several share registers, or stock books, not altogether harmonious, see *Noyes Bros.*, 136 Fed. 977, 980 (headnote inadequate).

³ *Plumb v. Bank of Enterprise*, 48 Kans. 484; 29 Pac. 699; *American Nat. Bank v. Oriental Mills*, 17

R. I. 551; 23 Atl. 795; *Fisher v. Jones*, 82 Ala. 117; 3 So. 13; *U. S. Cast Iron Pipe, etc. Co.* (N. J.), 65 Atl. 849 (where the cancelled certificates were pasted in); *Perkins v. Lyons*, 111 Iowa 192; 82 N. W. 486.

But see *Newell v. Williston*, 138 Mass. 240; *Tourtlot v. Stoleben*, 101 Fed. 362. Cf. *supra*, § 172, and *infra*, § 1129, § 1220.

⁴ *National Bank v. Watson town Bank*, 105 U. S. 217, 222.

when once a particular book has been adopted either formally or in practice as the company's registration book, no entry in any other book will be deemed a registration of the transfer unless it be intended that the latter book shall supersede the former.¹ Thus, where a note of a transfer is made in a small book kept at the secretary's office with an intention of entering it later in the large stock book kept at another place, it was held that the transfer could not be deemed to have been registered.²

§ 865. **What Entry amounts to Registration of a Transfer.** — As to what entries in a share register will be deemed a sufficient registration of a transfer, little need be said. Any entry indicative of an intention on the part of the company to recognize the transferee as shareholder in the room of the transferor with respect to certain shares will suffice.³ The entry of the transferee as holder of shares bearing the same numbers as those which are still allowed to stand in the name of the transferor has been

¹ Cf. *Pinkerton v. Manchester, etc. R. R. Co.*, 42 N. H. 424, 449 (where an entry in the books of a transfer agent in a foreign state was held insufficient on the ground that the law required the record of the transfer to be made on the books at the company's home office).

As to entries made in books in a foreign state, see also *Perkins v. Lyons*, 111 Iowa 192; 82 N. W. 486.

² *Harpold v. Stobart*, 46 Oh. St. 397; 21 N. E. 637; 15 Am. St. Rep. 618. The court said: "While it is not necessary that a book of any special kind be adopted for that purpose, yet when one is selected and used, that becomes the stock book, and transfers, to be valid, must be made upon that. The object to be accomplished by the keeping of such a book requires reasonable certainty as to its identity."

³ See *National Bank v. Watson-town Bank*, 105 U. S. 217, 222-223 (headnote inadequate); *Bank of Commerce v. Bank of Newport*, 63 Fed. 898, 901-902 (headnote misleading); 11 C. C. A. 484; *Chambersburg Ins. Co. v. Smith*, 11 Pa.

St. 120; *Plumb v. Bank of Enterprise*, 48 Kans. 484 (memorandum on stubs of certificates sufficient); *Upton v. Burnham*, 3 Biss. 431 (headnote inadequate); *Stewart v. Walla Walla, etc. Pub. Co.*, 1 Wash. St. 521 (headnote inadequate); 20 Pac. 605; *Perkins v. Lyons*, 111 Iowa 192; 82 N. W. 486 (entry in pencil on stub of certificate); *Fisher v. Jones*, 82 Ala. 117, 121-122; 3 So. 13; *Moore v. Marshalltown Opera-House Co.*, 81 Iowa 45; 46 N. W. 750.

Cf. *Cutting v. Damerel*, 88 N. Y. 410; *Northrop v. Curtis*, 5 Conn. 246; *Rankin v. Fidelity Trust Co.*, 189 U. S. 242, 251-252; 23 Sup. Ct. 553.

But see *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; *Northrop v. Newtown, etc. Turnpike Co.*, 3 Conn. 544, 551 (where it was said that a transfer is not registered unless copied at full length); *Newell v. Williston*, 138 Mass. 240.

As to entry of a transfer "subject to the rights of attaching creditors and others," see *State Ins. Co. v. Gennett*, 2 Tenn. Ch. 100, 103.

held insufficient.¹ The notion has been to some extent prevalent that a provision making shares transferable only on the books of the company means that the actual instrument of transfer must be a writing on the company's books.² But the true view is that such a provision merely requires that some note or record of the transfer be made on the books, and that any written transfer on the back of the certificate or elsewhere is still the effective instrument of transfer. Consequently, the entry of a transfer in the company's books is not the "execution of a written instrument."³

§ 866. **Power of Attorney to effect Registration of Transfer on behalf of Transferor.** — The ordinary American transfer endorsed upon a certificate of stock is usually coupled with a power of attorney — or, to speak more accurately, comprises a power of attorney — authorizing any one, the name being usually left blank in order that the transferee may fill it in at his own convenience, to apply for and effect in the transferor's name a transfer on the company's books. This express power of attorney would seem to be surplusage, inasmuch as the execution of a transfer would doubtless of itself be held to amount to a grant of implied authority to use the transferor's name in demanding registration of the transfer.⁴ Indeed, when once a formal transfer has been executed, the registration or entry thereof on the company's books may be accomplished by the officers of the company without any deputed authority from the transferor.⁵ Moreover, where the name of some particular person is inserted in the power of attorney, yet if he be unwilling, or neglect, to act, the rights of the transferee will not be prejudiced.⁶ The practice of giving these powers of attorney prob-

¹ *Heights of Maribyrnong Estate Co.*, 22 Vict. L. R. 438.

² *Marlborough Mfg. Co. v. Smith*, 2 Conn. 579; *Williams v. Mechanics' Bank*, 5 Blatchf. 59.

Cf. *Richmondville Mfg. Co. v. Prall*, 9 Conn. 487; *Northrop v. Curtis*, 5 Conn. 246. Compare also the English practice as to Bank of England stock and other "inscribed" stocks, *Shepherd v. Harris* (1905), 2 Ch. 310, 315-316.

³ *Pine v. Western Nat. Bank*, 65 Pac. 690, 692; 63 Kans. 462.

⁴ Cf. *Plymouth Bank v. Bank of Norfolk*, 10 Pick. (Mass.) 454, where the transfer was to two persons and the power of attorney was to one of them only.

⁵ *Green Mount, etc. Co. v. Bulla*, 45 Ind. 1.

But cf. *McFall v. Buckeye, etc. Ass'n*, 122 Cal. 468; 55 Pac. 253; 68 Am. St. Rep. 47.

See also *Mechanics' Banking Ass'n v. Mariposa Co.*, 3 Rob. (N. Y.) 395.

⁶ *Cushman v. Thayer Mfg. Jew-*

ably originated in the notion, which has been shown above to be unfounded,¹ that a transfer on the books means an actual instrument of transfer in writing on the company's books and is not satisfied by entering on the books a mere note or record of a transfer.²

The power of attorney does not have the effect of connecting the transferor with the person whose name as attorney is subsequently inserted so as to charge him with the latter's knowledge of facts which if communicated to the transferor would invalidate the transfer.³ In one federal case, the court said that if a failure to enter a transfer on the company's books was due to the person whose name was inserted in the power of attorney, he being an officer of the corporation, the default was attributable to him as agent of the transferor and not as agent for the company, so that the company could not be deemed responsible for the failure to register the transfer.⁴ But such a doctrine might be very inconvenient and indeed unjust in its practical operation; and it is submitted that the sound principle is that the usual "power of attorney" connected with an American transfer of shares is little if anything more than matter of form.⁵

§ 867. Issue of Share-Certificate to Transferee or Surrender of Transferor's Certificate not necessary to pass complete Title. — Of course the issue of a share-certificate to the transferee is not necessary in order to effect a passage of the legal title,⁶ nor is it necessary that the transferor's certificate should be surren-

elry Co., 76 N. Y. 365, 371; 32 Am. Rep. 315.

But cf. *Re Bachman*, 2 Fed. Cas. 310.

¹ *Supra*, § 865.

² Compare the English practice in respect to consols and Bank of England stock and other "inscribed" stock. *Starkey v. Bank of England* (1903), A. C. 114; *Shepherd v. Harris* (1905), 2 Ch. 310, 315-316.

³ *Johnston v. Laflin*, 103 U. S. 800.

⁴ *Re Bachman*, 2 Fed. Cas. 310.

⁵ But see *Taliaferro v. First Nat. Bank*, 71 Md. 200; *First Nat. Bank v. Taliaferro*, 72 Md. 164; *German Sav. Bank v. Renshaw*, 78 Md. 475, with which cases compare *Kern's Estate*, 35 Atl. 231; 176 Pa. St. 373.

⁶ *Chouteau Spring Co. v. Harris*, 20 Mo. 382; *National Bank v. Watson Bank*, 105 U. S. 217, 222 (headnote inadequate); *First Nat. Bank v. Gifford*, 47 Iowa 575; *Agricultural Bank v. Wilson*, 24 Me. 273.

dered.¹ The certificate is merely evidential in its legal operation; and the title of the transferee, if the transfer be registered, is quite as complete, both at law and in equity, before it is issued as afterwards. Even an express provision that shares shall be transferable only upon surrender of the transferor's certificate is construed as intended for the company's benefit, so that a failure to surrender the certificate would be waived by registering the transfer.²

§ 868. **Implied Transfers.** — In some cases transfers can be implied. For instance, a corporation accepts or attempts to accept a surrender of shares, and subsequently reissues the shares. Under some circumstances, where the surrender is, as such, invalid, the transaction may be construed as a transfer from the original holder to the second allottee so as to release the former from liability as a shareholder.³ Such a construction can, however, rarely if ever be adopted where the company has under its control other unissued shares to which the second allotment can be referred.⁴

§ 869. **"Certification" of Transfers.** — The English system of separating the transfer from the certificate, operating in conjunction with the greater length of time that elapses in England between the presentation of a transfer for registration and the actual registration and issue of a certificate to the transferee, has led to what is called "certification" of transfers. That is, when a transfer and share-certificate are deposited with the company preliminary to the registration of a transfer, the company issues a receipt acknowledging, or as it is called, "certifying" that a share-certificate has been lodged with the company. The in-

¹ *Boatmen's Ins. & Trust Co. v. Able*, 48 Mo. 136; *Bank of Kentucky v. Schuylkill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 247-249; *Colton v. Williams*, 65 Ill. App. 466. 41; *Wyman v. Bowman*, 127 Fed. 257, 266-267; 62 C. C. A. 189. See also *supra*, § 632.

Cf. *supra*, § 853, *infra*, § 882.

² As to the liability of the company to a holder of the certificate for registering a transfer without requiring a surrender of the certificate, see *infra*, § 910, § 938.

³ Cf. *Macdonald Sons & Co.* (1894), 1 Ch. 89, 101-102; *Ex parte Jones*, 27 L. J. Ch. 666; *Wells & Co. v. Thompson Mfg. Co.*, 54 Mo. App. 666.

But see *Cartwright v. Dickinson*, 88 Tenn. 476; 12 S. W. 1030; 17 Am. St. Rep. 910; 7 L. R. A. 706; *Scott v. Houghton*, 83 S. W. 1057; 73 Ark. 78 (where a creditor of the first allottee endeavored, but without success, to attach the shares on the ground that the transfer was not registered as required by statute).

⁴ *Wallscourt's Case*, 7 Manson 235; *Ex parte Jones*, 27 L. J. Ch. 666.

strument is a very informal one, consisting usually of some such words as these, "Certificate for * * * shares has been lodged at the company's office. Date * * *, Secretary." The corporate seal is not attached. The distinction between such a certification and the ordinary share-certificate is wide and fundamental.

As Lord Macnaghten said in a recent case in the House of Lords, "There is a marked difference between a certificate and a certification. A certificate is under the seal of the company. By the Companies Act, 1862, a certificate is made *prima facie* evidence of title. If faith were not given to the solemn assertions of a company under its common seal, 'it would,' as Lord Cairns observed in *Burkinshaw v. Nicolls*, 'paralyze the whole of the dealings with shares in public companies.' A certification stands on a different footing altogether. Transfers are never certified under the company's seal. There is no obligation on a company to certify transfers at all. The certification is not passed by the directors or brought before the board. A certification, in fact, is only required for a temporary purpose to meet the exigencies of business on the Stock Exchange, which has stated days and fixed periods for the different stages of a business transaction intended to be carried out under its rules. In dealings in shares not under the rules of the Stock Exchange, a certification is really out of place. In such dealings, in the case of a purchase, the price would only be paid in exchange for the transfer and share-certificate on the completion of the transaction, and not before."¹

Sometimes, the "certification" of a transfer is done, not by the company, but by the secretary of the stock exchange. For instance, if the holder of a certificate for one hundred shares sells fifty, he lodges the certificate with the secretary of the stock exchange, who issues to him two papers each certifying that a certificate representing fifty shares has been lodged. One of these papers the transferor delivers to the transferee as evidence of his ownership of the shares. The purchase money is thereupon paid; and afterwards the share-certificate is surrendered to the company, the transferee is registered as a shareholder and receives a certificate for his fifty shares, and another certificate is issued to the transferor for the fifty shares retained by him.

¹ *George Whitechurch, Ltd. v. Cavanaugh* (1902), A. C. 117, 126.

§ 870. **American Receipts corresponding to English Certifications.** — In America, “certification” of transfers of shares is by that name unknown. Often, when a certificate and transfer are presented at the office of an American corporation in order that the transfer may be registered, the company gives no receipt or acknowledgment of any kind similar to an English certificate of transfer. Sometimes a brief, informal acknowledgment of the receipt of the share-certificates is given. Such receipts are often marked “non-transferable,” and even where they are not, they are not often assigned or dealt in on the stock exchange as representing the shares. The English decisions relative to “certification” of transfers would be pertinent authority in respect to the nature and legal effect of such receipts.

§ 871. **Similar Receipts issued under Reorganization Schemes.** — Instruments similar in some respects to the English certifications of transfers are often issued under reorganization or amalgamation schemes. Shareholders deposit their shares with the trust company which is financing the reorganization or consolidation, and receive in exchange certificates or scrip. The law applicable to such scrip certificates is stated in another place.¹ Such certificates differ from English certifications in that they are usually intended to be transferred from hand to hand as quasi-negotiable instruments.

§ 872-§ 879. *Acceptance of Transfer by Transferee.*

§ 872. **Transfer complete without Acceptance.** — Transfers of shares, like other unilateral conveyances, are, according to the prevailing doctrines of law, complete upon registration without the necessity of any acceptance on the part of the transferee.² For instance, the transfer though gratuitous cannot be revoked by the transferor after registration but before the transferee has knowledge of it and therefore necessarily before he has accepted it.³ Sometimes the same result is reached by say-

¹ *Infra*, § 994. Cf. *supra*, § 237. 56 L. R. A. 728 (transferor not re-

² But the company cannot be relieved from liability as shareholder where transferee has not accepted the transferee is ready to accept it. shares and transfer not registered). *Infra*, § 930.

³ Cf. *Standing v. Bowring*, 31 Ch. D. 282 (a case of a gift of consols or public stocks). Cf. *Vermont, etc. Co. v. Declez*, 135 Cal. 579, 588-589; 67 Pac. 1057; 87 Am. St. Rep. 143;

ing that acceptance is presumed¹ from the supposedly beneficial character of the conveyance; but this is not the true ground historically, nor is it logical.

§ 873. **Effect of Renunciation of Shares by Transferee.** — According to all the authorities, however, if the transferee promptly repudiates the transfer upon receiving notice thereof, the title reverts to the transferor although the transfer has been registered;² and it has been held that if upon such repudiation by the transferee, his name is stricken from the register, the transferor becomes subject once more to the liabilities of a shareholder.³ Indeed, it might well be questioned whether prompt repudiation of the transfer by the transferee would not *ipso facto* revest the title in the transferor and make him liable as shareholder by relation as if no transfer had been executed.

§ 874. **How Acceptance of Transfer may be proved.** — Acceptance or disaffirmance by the transferee can often be proved only by parol. Whilst the burden of disproving acceptance ordinarily rests upon the party who denies it,⁴ and therefore upon a transferee who is seeking to escape from the liabilities attaching to ownership of shares, yet the burden may be shifted upon the company or its liquidator or receiver by the transferee's sworn testimony that he knew nothing of the transfer until immediately before his repudiation thereof.

The acceptance of dividends would ordinarily be conclusive evidence of acceptance.⁵ So, a transferee who retains the transfer in his possession and does not notify the transferor of his re-

¹ Cf. *Burke v. Smith*, 16 Wall. 390, 400; *South Texas Nat. Bank v. Texas, etc. Lumber Co.* (Texas), 70 S. W. 768; 30 Tex. Civ. App. 412.

² *Ex parte Heritage*, 9 Eq. 5; *Simmons v. Hill*, 96 Mo. 679; 10 S. W. 61; 2 L. R. A. 476.

Cf. *Mechanics Banking Ass'n v. Mariposa Co.*, 3 Rob. (N. Y.) 395; *Welch v. Gillelen*, 82 Pac. 248; 147 Cal. 571 (transferee who repudiated not liable as shareholder); *Sigua Iron Co. v. Greene*, 104 Fed. 854; 44 C. C. A. 221 (transferee not liable as shareholder without acceptance — headnote misleading); *Paton's Case*, 5 Ont. L. R. 392 (holding that a power of attorney to accept shares

cannot be used to validate a transfer from a director to the principal made and registered without the knowledge of the attorney and after the latter had accepted a share-certificate from the company itself, which had some unallotted shares).

³ *Ex parte Heritage*, 9 Eq. 5.

⁴ *South Texas Nat. Bank v. Texas, etc. Lumber Co.* (Texas), 70 S. W. 768; 30 Tex. Civ. App. 412; *Finn v. Brown*, 142 U. S. 56, 67; 12 Sup. Ct. 136. Cf. *infra*, § 1128.

But see *Sigua Iron Co. v. Greene*, 88 Fed. 207, 213-214.

⁵ *Ker's Case*, 4 A. C. 549.

Cf. *Royal Bank of India's Case*, 4 Ch. 252 259.

pudiation of it may be estopped from denying his acceptance.¹ Moreover, if one of several trustees authorizes the investment of certain of the trust moneys in the shares of a certain company, and the moneys are so invested in the names of all the trustees he is deemed to have accepted, especially if he has signed a letter written to the company about the payment of dividends.² A sale by the transferee of some of the transferred shares is a sufficient acceptance of the transfer.³ Indeed, the execution of a transfer on the back of the share-certificate, without receiving any purchase money and without in fact intending to claim any interest in the shares, is a sufficient acceptance of the shares.⁴

The transferee's acceptance may be shown although he did not explicitly authorize the registration of the transfer. Thus, after a contract of sale of shares has been made, the vendor is justified in having the transfer registered without the purchaser's knowledge, and the latter, having accepted in advance, cannot escape liability as shareholder by subsequently repudiating the transfer.⁵ So, if a person has given his assent to a course of dealing which involves transferring shares to his name from time to time, acceptance of each particular transfer need not be proved.⁶ But a voluntary promise to purchase certain shares when issued to the promisee contemplates a unilateral contract, and may therefore be withdrawn at any time before the shares have been registered in the promisor's name.⁷

If the transferee is a director and the shares are necessary to qualify him, acceptance is easily inferred.⁸ Indeed, if the transferee is an officer having charge of the transfer book, it seems that in order to avoid the burdens of ownership of the shares he must cancel the transfer or enter a transfer back to the transferor.⁹

§ 875. **Inconvenience of trusting to Parol Proof of Acceptance.**—The doctrines of law stated in the foregoing paragraphs lead

¹ *Shepherd v. Gillespie*, 3 Ch. 764.

⁶ *Nicol's Case*, 3 De G. & J. 387.

² *Cunninghame v. City of Glasgow Bank*, 4 A. C. 607.

⁷ *Greene v. Sigua Iron Co.*, 88 Fed. 203.

³ *Royal Bank of India's Case*, 4 Ch. 252, 259.

⁸ *Finn v. Brown*, 142 U. S. 56; 12 Sup. Ct. 136.

⁴ *Kenyon v. Fowler*, 155 Fed. 107.

⁹ *Finn v. Brown*, 142 U. S. 56, 71;

⁵ *Webster v. Upton*, 91 U. S. 65, 12 Sup. Ct. 136. 71-72.

Cf. *Greene v. Sigua Iron Co.*, 88 Fed. 203.

to the undesirable result that important rights and serious liabilities depend upon the fact of acceptance or repudiation of a transfer — a fact which can often be proved only by parol. This inconvenience is greater in the case of shares in corporations than in the case of transfers of real estate; because in the case of land acceptance can generally be proved by notorious facts such as taking possession, collecting rents, paying taxes, and so forth. Moreover, shares are liable to great and sudden fluctuations of value, so that the incentive may be strong to induce a transferee to repudiate a transfer when the company gets into difficulties, although his real intention at the time was to accept it. Upon the whole, the desirability of requiring acceptance on the part of the transferee to be evidenced in writing before the transfer is registered is apparent.

§ 876. **Regulations requiring Transfer to be executed by Transferee as well as Transferor.** — Accordingly, the regulations of some English corporations require a transfer of shares to be executed by the transferee as well as by the transferor.¹ The reasonableness of such a regulation is abundantly supported by the considerations mentioned in the last paragraph;² and some American corporations might perhaps do well by their by-laws to adopt a similar requirement.³ Such regulations are satisfied, so that the transfer is valid and entitled to registration, if the transferee enters into direct contractual relations with the company; and the transferee will be deemed for all purposes a shareholder if he act as such, although he may never have formally executed the required paper.⁴ Even where the regulations do not expressly require a transfer to be executed by the transferee, yet if the uniform practice of the company has been to require execution by both parties, it may refuse to register a transfer which *ex facie* contemplates execution both by transferor and transferee but which in fact is executed by the former alone.⁵

¹ See *Ortigosa v. Brown*, 38 L. T. 145; *Roots v. Williamson*, 38 Ch. D. 485. for execution of an acceptance of the transfer before the transfer could be registered.

² *Marino's Case*, 2 Ch. 596, 601.

³ One inconvenience consequent upon such a regulation would be that the purchaser's broker who usually sees to the registration of the transfer would have in each case to present the certificate to his client

⁴ *Re Taurine Co.*, 25 Ch. D. 118 (semble); *Murray v. Bush*, L. R. 6 H. L. 37; *Royal Bank of India's Case*, 4 Ch. 252, 259.

But see *Ortigosa v. Brown*, 38 L. T. 145.

⁵ *Marino's Case*, 2 Ch. 596.

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¹ Cf. *Christopher v. Norvell*, 201 U. S. 216; 26 Sup. Ct. 502; *Kerr v. Urie*, 86 Md. 72; 37 Atl. 789; 63 Am. St. Rep. 493; 38 L. R. A. 119; *Tucker v. Curtin*, 148 Fed. 929; 78 C. C. A. 557 (holding that transfer of shares in ordinary way from husband to wife is a transfer through a third person, namely the corporation, within the meaning of a rule of Massachusetts law by which a transfer of personal property from a husband to his wife without the intervention of a third person is constructively fraudulent as against his creditors).

² *Regina ex rel. Blackburn v. Midland Counties Ry.*, 15 Ir. Com. L. 514, 522 (semble).

Cf. *Lumsden's Case*, 4 Ch. 31.

³ *Capper's Case*, 3 Ch. 458; *Mann's Case*, 3 Ch. 459 n. Cf. *Brown v. Black*, 8 Ch. 939.

⁴ *Aldrich v. Bingham*, 131 Fed. 363.

⁵ *Lumsden's Case*, 4 Ch. 31.

⁶ *Symon's Case*, 5 Ch. 298.

⁷ *Regina ex rel. Blackburn v. Midland Counties Ry.*, 15 Ir. Com. L. 514.

⁸ *Regina ex rel. Blackburn v. Midland Counties Ry.*, 15 Ir. Com. L. 514, 521-522.

to execute a transfer to an infant whether the or not. Where the transfer is made to an assignee of an adult, the infant's name cannot pass as that of the *cestui que trust*, so the liquidator in putting the name of shareholders.¹

§ 876

rees. — If the transferee be the assignee of the transfer would compel the company to register such a transfer, if the transferee is considered before the company is thrown into liquidation, the transfer is valid, and the assets of the transferee company are not subject to any liability attaching to the ownership of the

§ 879. **Fictitious Transferee.** — A transfer to a fictitious transferee is wholly void even though it be entered on the company's books.² There cannot be a transfer without a transferee.

§ 880. **Incapacity of Transferor.** — Any legal incapacity of the transferor of course invalidates the transfer. For example, a transfer by an infant is voidable, and if he elect to disaffirm, no title passes; and if the transfer has been registered, he may compel the company to reinstate him as shareholder or may pursue any of the other remedies open to a shareholder whose name has been stricken from the register in pursuance of an invalid transfer. The same law applies to a transfer by a lunatic,³

¹ *Massey & Giffin's Case* (1907), 191. As to effect of share-certificate in the name of a fictitious person, 1 Ch. 582. Cf. *supra*, § 767.

² *Franklin Bank v. Commercial Bank*, 36 Oh. St. 350; 38 Am. Rep. 594. Cf. *infra*, § 1049.

³ *Infra*, § 1034, § 1049, § 1231.

⁴ *Barned's Banking Co.*, 3 Ch. 105, 243. 117-118.

⁵ *Muskingum Valley Turnpike Co. v. Ward*, 13 Oh. 120; 42 Am. Dec. 31 Cal. 629.

at all events unless it appear that he has received full value and has not been imposed upon. All these and similar questions are governed by the general law of infancy, lunacy, coverture, etc., and not by any peculiar principles applicable to shares in incorporated companies.

§ 881-§ 889. *Application of General Principles as to Completeness of Transfers to Special Cases.*

§ 881. **Enumeration of Five Classes of Special Cases.** — The principles which have been set forth above as to the method of making valid and complete transfers may require to be applied in several classes of special cases arising between various parties: (1) between a *cestui que trust* and a purchaser from the trustee, without notice of the trust; (2) between donee and donor; (3) between successive transferees from the same transferor; (4) between the transferor and creditors of the transferor, or the representative of creditors of the transferor; (5) where transfers have passed from hand to hand, like negotiable instruments. Of these in their order:

§ 882. **Between Cestui Que Trust and Purchaser from Trustee.** — As between a *cestui que trust* and a purchaser from a misbehaving trustee, the question is simply, Has the purchaser acquired a legal as distinguished from an equitable right before receiving notice of the *cestui que trust's* claim? So long as the purchaser's right is equitable merely, the equity of the *cestui que trust*, being prior in time, is the stronger in law.¹ But in order that the *bona fide* purchaser should prevail, it is not necessary that he should be actually registered as shareholder, or should acquire the technical and complete legal title to the shares as explained above: he will be protected if, before learning of the *cestui que trust's* claims, he gets possession of the indicia of ownership, and clothes himself with authority sufficient to enable him to procure registration without calling upon the transferor to do any further act.² This he does, whenever he

¹ *Roots v. Williamson*, 38 Ch. D. 485; *Moore v. North Western Bank* 424; *Winter v. Montgomery Gas* (1891), 2 Ch. 599; *Ireland v. Hart Light Co.*, 89 Ala. 544; 7 So. 773. (1902), 1 Ch. 522.

² *Dodds v. Hills*, 2 Hem. & Miller, 485; *Moore v. North Western Bank* 424; *Winter v. Montgomery Gas* (1891), 2 Ch. 599; *Ireland v. Hart Light Co.*, 89 Ala. 544; 7 So. 773. But see *Roots v. Williamson*, 38

gets possession of the share-certificate with a transfer in regular and ordinary form.¹ Consequently, a purchaser or mortgagee from a trustee, who pays his money and receives the share-certificate coupled with a transfer, without notice of the trust, will be preferred to the *cestui que trust*, although he is notified of the latter's rights before presenting the transfer for registration and thus actually clothing himself with complete legal title.² If the purchaser from the trustee is actually registered as shareholder, his title is superior to that of the *cestui que trust*, although the share-certificate may not have been delivered to him by the trustee, having been in the possession of the *cestui que trust*.³ The only ground on which a different result could well be reached would be that a transferee who does not get the share-certificate should be charged with notice of any rights of the holder of the certificate.

§ 883. *Where the Company itself is Cestui que Trust or has some Equity against the Transferor.* — A special class of cases coming under the general head which we are now considering is where the purchaser of shares is sought to be affected with some equity which existed in favor of the company against his transferor. The rule in such cases is that a purchaser for value of the shares without notice of the company's equity takes discharged therefrom. Of course, if the company allows the transfer to be registered, it would by so doing waive its equity. But even where registration is refused, the company would be estopped from setting up its right against a *bona fide* purchaser of the share-certificate. Thus, a corporation cannot refuse to register a transfer because of a lien in its own favor which was

Ch. D. 485; *Moore v. North Western Bank* (1891), 2 Ch. 599; *Ireland v. Hart* (1902), 1 Ch. 522.

¹ *Dodds v. Hills*, 2 Hem. & Miller 424; *Winter v. Montgomery Gas-Light Co.*, 89 Ala. 544; 7 So. 773;

Salisbury Mills v. Townsend, 109 Mass. 115; *Anderson v. Waco State Bank*, 92 Tex. 506; 49 S. W. 1030;

71 Am. St. Rep. 867; *Ross v. South-western R. R. Co.*, 53 Ga. 514; *Gurley v. Reed*, 190 Mass. 509; 77 N. E. 642.

Dougherty, 62 Oh. St. 589; 57 N. E. 455 (where the *bona fide* transferee was protected although he acquired knowledge of the prior equity before delivery of the certificates).

² *Dodds v. Hills*, 2 Hem. & Miller, 424.

³ *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30, 78-81.

Cf. *First Nat. Bank v. Gifford*, 47 Iowa 575 (where no certificate had ever been issued to the trustee).

Cf. *Dueber, etc. Mfg. Co. v.*

created by the transferor, but of which the purchaser of the certificate had no notice.¹ Where the company colorably issues shares for the purpose of qualifying the holder as a director, the trust or equity in favor of the company is not regarded as of great merit, so that the company's claim will be postponed to that of a person to whom the director has agreed to sell or pledge the shares:² the equities are not deemed equal, and hence the company's priority in point of time is of no avail.

§ 884. **Between Donor and Donee.**—As between a donee and donor of shares the rule to be applied is that while equity will not aid an incomplete gift, yet its assistance will not be lent to the donor to enable him to revoke his gift. Consequently, if the donee has obtained dominion over the shares so that he can perfect his rights without calling upon the donor to do any further act, the gift will be irrevocable by the donor even though the technical legal title to the shares may not have been vested in the donee by registration. Accordingly, where the donor has delivered the share-certificates to the donee endorsed in the usual way, the latter's title is so far complete that nothing that the donor can do can impair it or prevent the donee from requiring the company to register him as shareholder;³ and, indeed, even a parol delivery of the certificate without any endorsement or written transfer will have the same effect.⁴ If no share-certificates have been issued, a gift by execution and delivery of a transfer under seal has been held to be complete.⁵

¹ *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447; 24 S. W. 129. Cf. *supra*, § 706, § 707.

² *Dueber, etc. Mfg. Co. v. Dougherty*, 62 Oh. St. 589; 57 N. E. 455.

³ *Grymes v. Hone*, 49 N. Y. 17; 10 Am. Rep. 313.

⁴ *Reed v. Copeland*, 50 Conn. 472; 47 Am. Rep. 663; *Commonwealth v. Compton*, 137 Pa. St. 138; 20 Atl. 417; *Walsh v. Sexton*, 55 Barb. (N. Y.) 251 (gift *mortis causa*); *Gilkinson v. Third Ave. R. R. Co.*, 47 N. Y. App. Div. 472; 63 N. Y. Supp. 792; *Bond v. Bean*, 72 N. H. 444; 57 Atl. 340; *First Nat. Bank v. Holland*, 99 Va. 495; 39 S. E. 126; 86 Am. St. Rep. 898; 55 L. R. A. 155; *Larimer v. Beardsley* (Iowa),

107 N. W. 935 (where the certificate was delivered to a trustee for the donee, who was accordingly allowed to maintain a bill to compel the trustee to transfer the shares to her).

But see *Matthews v. Hoagland*, 48 N. J. Eq. 455; 21 Atl. 1054.

Cf. *Colton v. Williams*, 65 Ill. App. 466 (a peculiar case stated *supra*, § 863); *Nicolls v. Reid*, 109 Cal. 630; 42 Pac. 298.

As to gift from husband to wife, see *Tucker v. Curtin*, 148 Fed. 929; 78 C. C. A. 557; *First Nat. Bank v. Holland*, *ubi supra*.

⁵ *De Caumont v. Bogert*, 36 Hun. (N. Y.) 382.

These rules are not accepted in Maryland, where the courts have adopted the doctrine that until the donee has perfected his title by having the transfer registered, the donor may revoke it,¹ and of course his death operates as a revocation. The rule in England seems to be the same as in Maryland.²

It has been said in New York that the mere entry of a transfer of shares in the company's books cannot be a complete gift unless the donee be invested in some further way with dominion over the shares;³ but one may doubt whether this dictum embodies sound law.⁴

In all the United States a mere voluntary executory promise to cause shares to be transferred may be revoked by the donor.⁵ Moreover, a delivery of the share-certificates with transfers endorsed thereon to the company's secretary, coupled with directions to hold the certificates subject to the transferor's order and in case of her death to deliver them to the transferees is clearly not a completed gift *mortis causa*.⁶

§ 885. **Between Successive Transferees from same Transferor.**—Difficult questions sometimes arise between successive transferees from the same transferor. The registered owner first executes a formal transfer to A and subsequently but before the first transfer is presented for registration executes another transfer to B. Neither transfer having been registered, who has the better right to the shares, A or B? Other things being equal the first transferee has the better right:⁷ *qui prior est tempore potior est jure*. Wherever either by law or by custom transfers should be registered only upon surrender of the certificate issued to the transferor, the transferee who gets possession of the certificate would seem to have a stronger right

¹ *Baltimore Retort, etc. Co. v. Mali*, 65 Md. 93; 3 Atl. 286; 57 Pac. 370.

² *Griffin v. Knoblock* (Colo.), 77 Am. St. Rep. 304; *Pennington v. Gittings*, 2 Gill & J. (Md.) 208.

³ *Noble v. Learned* (Cal.), 87 Pac. 402; *Noble v. Garden*, 146 Cal. 225; *Milroy v. Lord*, 4 De G. F. & J. 79 Pac. 883.

⁴ *Société Générale de Paris v. Walker*, 11 A. C. 20; *Peat v. Clayton* (1906), 1 Ch. 659. As to the circumstances under which a transfer to the company itself will be postponed in law to a subsequent transfer to a third person, see *Hill v. Atoka Coal, etc. Co.*, 21 S. W. Rep. 508 (Mo.).

⁵ *Richardson v. Emmett*, 61 N. Y. App. Div. 205; 70 N. Y. Supp. 546.

⁶ *See supra*, § 853.

than a person claiming under a prior transfer without the certificate.¹ The failure to deliver the certificate would be deemed a suspicious circumstance sufficient to subordinate the rights of the prior transferee to those of the holder of the certificate.² If a transferee who has not possession of the certificate is registered by the company as shareholder, he becomes clothed with complete legal title and as a *bona fide* purchaser for value would take precedence over a person having a mere equitable title under another transfer either prior or subsequent to his own,³ unless the non-delivery of the certificate should be deemed so suspicious a circumstance as to charge him with notice of the rights of the possessor of the certificate. *A fortiori*, a transferee to whom the certificate is delivered and who is duly registered takes a better title than a person claiming under a prior unregistered transfer, which was disconnected from the certificate, and of which he had no notice.⁴ At any rate, the holder of the certificate would have a right against the company by estoppel,⁵ or have a cause of action for registering a transfer without insisting on production of the certificate.⁶

These questions between successive transferees arise much more frequently in England than in the United States; for in this country the practice of endorsing the transfer upon the certificate itself is so general and inveterate that one rarely thinks of taking a transfer in any other form. If the certificate

¹ Cf. *Third Nat. Bank v. Buffalo German Ins. Co.*, 193 U. S. 581; 24 Sup. Ct. 524. *v. Brantingham*, 77 N. Y. App. Div. 280; 79 N. Y. Supp. 190; *Price v. Morning Star Mining Co.*, 83 Mo. App. 470 (headnote inadequate —

² But see *Peat v. Clayton* (1906), 1 Ch. 659 (where the prior transfer was a general assignment for the benefit of creditors) where an assignee of the right to dividends was preferred to a subsequent transferee of the legal title,

³ *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30, 78-81; *Cady v. Potter*, 55 Barb. (N. Y.) 463. in respect to dividends declared before the legal title vested in the second transferee, but postponed to him with respect to all dividends declared thereafter).

But see *Bridgeport Bank v. N. Y., etc. R. R. Co.*, 30 Conn. 231. But see *Peat v. Clayton* (1906), 1 Ch. 659 (where the entry of the second transfer on the registry was subsequently stricken out by the company).

Subsequent cancellation of an entry of a transfer on the books is of course quite nugatory. *Cady v. Potter*, *ubi supra*.

⁴ *Mahany v. Walsh*, 16 N. Y. App. Div. 601; 44 N. Y. Supp. 969. ⁵ *Infra*, § 910.

⁶ *Infra*, § 938.

Cf. *Printing Telegraph News Co.*

were lost or destroyed, the owner would find himself unable to obtain a purchaser for the shares without first procuring a new certificate to be issued to him by the company. But whenever cases arise of successive transfers, the principles above stated are those which should be applied.

§ 886. **Between Transferee and Creditors of Transferor — Rights of attaching Creditors.** — As between a transferee and an attaching creditor of the transferor, it would seem to be immaterial whether the legal title or only an equitable right has passed to the transferee. In either case, the attaching creditor, not being a purchaser for value, should be subordinated to a prior transferee. For this reason, after a transfer has been made by endorsement and delivery of the share-certificate, the rights of the transferee should certainly be held superior to those of a creditor of the transferor levying upon the shares as his debtor's property,¹ even though it be provided that shares shall be transferable only on the books of the company.² The contrary has,

¹ *Young v. South Tredegar Iron Co.*, 85 Tenn. 189; 2 S. W. 202; 4 Am. St. Rep. 752; *Newberry v. Detroit, etc. Iron Co.*, 17 Mich. 141; *Pilot v. Johnson*, 33 La. Ann. 1286; *Boston Music Hall v. Cory*, 129 Mass. 435; *Scott v. Pequonnock Nat. Bank*, 21 Blatchf. 203; *Allen v. Stewart*, 7 Del. Ch. 287; 44 Atl. 786; *Barse Live Stock Co. v. Range Valley Cattle Co.*, 16 Utah 59; 50 Pac. 630; *U. S. v. Vaughan*, 3 Bin. (Pa.) 394; 5 Am. Dec. 375; *Commonwealth v. Watmough*, 6 Whart. 117; *Finney's Appeal*, 59 Pa. St. 398; *Cornick v. Richards*, 3 Lea (Tenn.) 1 (with which compare *State Ins. Co. v. Sax*, 2 Tenn. Ch. 507, and *State Ins. Co. v. Gennett*, 2 Tenn. Ch. 100); *Lipscomb v. Condon*, 56 W. Va. 416; 49 S. E. 392; 107 Am. St. Rep. 938; 67 L. R. A. 670 (where no share-certificate had been issued to the transferee); *Loveman v. Henderson*, 1 Tenn. Ch. App. 749 (where there was no written transfer); *Farmers, etc. Bank v. Mosher*, 100 N. W. 133; 94 N. W. 1003; 68 Nebr. 713; *Morton v. Cowan*, 25 Ont. 529. 93 Fed. 603; 35 C. C. A. 476; *Broadway Bank v. McElrath*, 13 N. J. Eq. 24; *Lund v. Wheaton Roller Mill Co.*, 50 Minn. 36; 52 N. W. 268; 36 Am. St. Rep. 623; *Wilson v. St. Louis, etc. Ry. Co.*, 108 Mo. 588; 18 S. W. 286; 32 Am. St. Rep. 624; *Tombler v. Palestine Ice Co.*, 17 Tex. Civ. App. 596; 43 S. W. 896; *Colt v. Ives*, 31 Conn. 25; 81 Am. Dec. 161; *Comeau v. Guild Farm Oil Co.*, 3 Daly (N. Y.) 218; *Hubbard v. Bank of U. S.*, 12 Fed. Cas. 777 (headnote inadequate); *New York Commercial Co. v. Francis*, 83 Fed. 769; 28 C. C. A. 199; *Continental Nat. Bank v. Eliot Nat. Bank*, 7 Fed. 369 (where the creditor had no notice of the transfer); *Smith v. Am. Coal Co.*, 7 Lans. (N. Y.) 317; *Clark v. German Security Bank*, 61 Miss. 611; *Port Townsend Nat. Bank v. Port Townsend Gas, etc. Co.*, 6 Wash. 597; 34 Pac. 155; *Seeligson v. Brown*, 61 Tex. 114; *Thurber v. Crump*, 86 Ky. 408; 6 S. W. 145; *Mapleton Bank v. Standrod* (Idaho), 71 Pac. 119; 8 Idaho 740; 67 L. R. A. 656. Cf. *Scripture v. Francetown Soapstone Co.*, 50 N. H. 571, where the

² *Masury v. Arkansas Nat. Bank*,

however, been held in some states.¹ If the transferee sleeps on his rights for several years after the shares are levied upon and sold as the property of the transferor, he will be barred by laches.² Of course, if the prior unrecorded transfer is executed in fraud of creditors, then upon familiar principles the subsequent attachment will prevail over the fraudulent conveyance,

same result was reached but only on the ground that the creditor had actual notice of the unrecorded transfer. As to which, see also *Black v. Zacharie*, 3 How. 483; *Nicollet Nat. Bank v. City Bank*, 38 Minn. 85; 35 N. W. 577; 8 Am. St. Rep. 643; *Cheever v. Meyer*, 52 Vt. 66; *Weston v. Bear River, etc. Co.*, 6 Cal. 425; *Naglee v. Pacific Wharf Co.*, 20 Cal. 529; *People v. Elmore*, 35 Cal. 653; *Bridgewater Iron Co. v. Lissberger*, 116 U. S. 8; 6 Sup. Ct. 241 (a case originating in Massachusetts and applying the law of that state); *May v. Cleland*, 117 Mich. 45; 75 N. W. 129; 44 L. R. A. 163 (the purchaser at the sheriff's sale having notice of the transfer); *Rogers v. Stevens*, 8 N. J. Eq. 167 (the purchaser having notice of the transfer).

¹ *Fisher v. Essex Bank*, 5 Gray (Mass.) 373; *Fort Madison Lumber Co. v. Batavian Bank*, 71 Iowa 270; 32 N. W. 336; 60 Am. Rep. 789 (the attaching creditor having no notice of the assignment); *State ex rel. Koons v. First Nat. Bank*, 89 Ind. 302; *People's Bank v. Gridley*, 91 Ill. 457; *Buttrick v. Nashua, etc. R. R. Co.*, 62 N. H. 413; 13 Am. St. Rep. 578 (where the attaching creditor had no notice of the transfer); *Re Murphy*, 51 Wisc. 519; 8 N. W. 419; *Weston v. Bear River, etc. Co.*, 5 Cal. 186; 63 Am. Dec. 117 (limited by *Weston v. Bear River, etc. Co.*, 6 Cal. 425, to cases where the creditor is without notice of the transfer, and followed with some reluctance in *Naglee v. Pac. Wharf Co.*, 20 Cal. 529); *Conway v. John*, 14 Colo. 30; 23 Pac. 170; *Williams*

v. Mechanics' Bank, 5 Blatchf. 59; *Oxford Turnpike Co. v. Bunnell*, 6 Conn. 552; *Skowhegan Bank v. Cutler*, 49 Me. 315; *Ottumwa Screen Co. v. Stodghill*, 103 Iowa 437; 72 N. W. 669 (where the creditor had notice of the transfer prior to the levy); *Perkins v. Lyons*, 111 Iowa 192; 82 N. W. 486 (where the creditor likewise had notice); *Simmons v. Hill*, 96 Mo. 679; 10 S. W. 61; 2 L. R. A. 476 (where the creditor had no notice of the transfer).

Cf. *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 99; 19 Am. Dec. 306; *Andrews v. Worcester, etc. R. R. Co.*, 159 Mass. 64; 33 N. E. 1109; *Coleman v. Spencer*, 5 Blackf. (Ind.) 197; *First Nat. Bank v. Hastings*, 7 Colo. App. 129; 42 Pac. 691; *Isbell v. Graybill*, 19 Colo. App. 508; 76 Pac. 550; *Sibley v. Quinsigamund Nat. Bank*, 133 Mass. 515; *Farmers' Nat. Gold Bank v. Wilson*, 58 Cal. 600; *West Coast Safety, etc. Co. v. Wulff*, 133 Cal. 315; 65 Pac. 622; 85 Am. St. Rep. 171.

The same rule is sometimes prescribed by express statute. *Goyer, etc. Co. v. Wildberger*, 71 Miss. 438; 15 So. 235; *Fahrney v. Kelly*, 102 Fed. 403 (where the attaching creditor had notice of the unrecorded assignment); *Hair v. Burnell*, 106 Fed. 280 (where the attaching creditor had notice); *Scott v. Haupt*, 83 S. W. (Ark.) 1057; 73 Ark. 78 (same point as last case); *Cates v. Baxter*, 97 Tenn. 443; 37 S. W. 219 (where the right under an executory contract of subscription was attached).

² *Noble v. Turner*, 69 Md. 519; 16 Atl. 124.

but the mere failure to record the transfer on the books is not conclusive evidence of fraud.¹ A transfer subsequent to the levying of the attachment should clearly be subordinated to the attachment, although the share-certificates were not seized by the sheriff;² but in connection with such cases, it should always be borne in mind that by the law of some states a seizure of the share-certificates may be necessary in order to constitute a valid attachment of the shares.

§ 887. *Rights of Trustee in Bankruptcy.* — An assignee in bankruptcy succeeds to such rights only as the bankrupt had, and cannot be deemed a purchaser for value. Hence, he cannot claim the shares as against a person claiming under a prior unregistered transfer from the bankrupt.³

§ 888. *Transfers in Fraud of Creditors.* — In cases where an unrecorded transfer is set up against creditors or an assignee in bankruptcy as their representative, the failure to enter the transfer on the books may be a suspicious circumstance to be weighed in connection with other evidence upon the issue of fraud; but standing alone it is not proof of fraud.⁴ If the certificates are immediately redelivered by the transferee to the transferor, there arises a strong presumption that the transfer was merely colorable and fraudulent as against the transferor's creditors.⁵ Even if fraud be proved, if the company, after notice of the claims of creditors or of their representative but without notice of the actual fraudulent intent with which the transfer was executed, registers the transfer, it will not be liable for so doing.⁶

¹ See *infra*, § 888.

² *Harris v. Bank of Mobile*, 5 La. Ann. 538; *Shenandoah Valley R. R. Co. v. Griffith*, 76 Va. 913, 922-923.

Cf. *McClintock v. Central Bank*, 120 Mo. 127; 24 S. W. 1052.

But see *Clews v. Friedman*, 182 Mass. 555; 66 N. E. 201 (depending upon a peculiar Massachusetts statute).

³ *Dickenson v. Central Nat. Bank*, 129 Mass. 279; 37 Am. Rep. 351.

Cf. *Sibley v. Quinsigamund Nat. Bank*, 133 Mass. 515.

But see *Shipman v. Aetna Ins. Co.*, 29 Conn. 245.

⁴ *Scripture v. Francetown Soapstone Co.*, 50 N. H. 571, 589-590; *Colt v. Ives*, 31 Conn. 25, 36-38; 81 Am. Dec. 161; *New York Commercial Co. v. Francis*, 83 Fed. 769; 28 C. C. A. 199; *Culp v. Mulvane*, 71 Pac. 273; 66 Kans. 143.

But see *Pinkerton v. Manchester, etc. R. R.*, 42 N. H. 424.

⁵ *McFall v. Buckeye, etc. Ass'n*, 122 Cal. 468; 55 Pac. 253; 68 Am. St. Rep. 47.

⁶ *Dickenson v. Central Nat. Bank*, 129 Mass. 279; 37 Am. Rep. 351.

Where the certificate is retained in the possession of the transferor, the courts will be very apt to hold the transaction to be in fraud of creditors of the transferor.¹

§ 889. **Transfers which have passed from Hand to Hand — Transfers in Blank.** — Another class of cases in which questions as to the validity of transfers of shares are raised consist of cases where written transfers of shares (in America usually endorsed upon the certificates) have passed from hand to hand. A transfer cannot well pass from hand to hand except where the transfer as signed by the transferor contains a blank for the name of the transferee. To execute transfers in blank in this way is the ordinary American custom, and is by no means uncommon in England. In these cases, the rule is that, apart from the somewhat elastic applications of the principle of estoppel, the person claiming under the transfer must show that it was executed by the transferor or his duly authorized agent in the form in which the claimant relies upon it or that blanks have been filled up in pursuance of authority conferred by the transferor, and that the claimant is either the original transferee or derives title from him by a regular chain.² Inasmuch as neither the certificate nor the written transfer is a negotiable instrument, it is not enough that the claimant may have got possession of the certificate, and transfer *bona fide*, and may have given value therefor.³

The validity of transfers in blank is seriously interfered with by a requirement that transfers be under seal;⁴ but where transfers are not required to be under seal, the presence of a seal attached to a transfer in blank will not vitiate any parol authority of the transferee to fill up the blank, and this is true even according to the strict English rules, the seal being regarded as mere surplusage.⁵ The extent of the actual authority con-

¹ *Atkinson v. Foster*, 134 Ill. 472; *Compress Co.*, 72 Miss. 323 (head-note misleading); 16 So. 530. This

² But the original transferor, who buys the certificate back from the transferee or any person to whom the transferee transfers it, is entitled to rely on his legal title so as to prevail over any equitable rights created by the transferee or any subsequent holder of the certificate. *Timberlake v. Shippers'*

³ See *supra*, § 842.

⁴ *Supra*, § 847.

⁵ *Ortigosa v. Brown*, 38 L. T. 145; *Ireland v. Hart* (1902), 1 Ch. 522, 525-526.

Cf. *Bridgeport Bank v. New York, etc. R. R. Co.*, 30 Conn. 231, 273-275.

ferred by the transferor to fill up material blanks rests entirely in parol, and is not apparent from the instrument itself.

Authority to fill up blanks, whatever its extent may be, may be exercised as well after the death of the transferor as in his lifetime.¹

Where the actual authority conferred by the transferor is exceeded, the transferee may often be protected by the principle of estoppel.²

§ 890-§ 923. ESTOPPEL.

§ 890. **Classification of Cases of Estoppel.** — A very large proportion of the cases relating to the law of transfers of shares turn on the question whether a person who, according to the strict rules of law above stated, would be without title is protected from loss by the principle of estoppel. This protection may be afforded either by an estoppel against the legal owner of the shares or by an estoppel against the company. These two kinds of estoppel will be considered separately.

§ 891-§ 907. *ESTOPPEL OF OWNER OF SHARES TO DENY TITLE OF PERSON CLAIMING UNDER A VOID TRANSFER.*

§ 891. **General Principles which apply without Reference to the Cause of the Invalidity of the Transfer.** — First, then, we should inquire what circumstances will be sufficient to estop the true and legal owner of shares from denying the validity of a transfer which, according to the principles above set forth, is void as against any one who is free to allege the truth. In general terms, we may say that the circumstances which will raise such an estoppel against the true owner of shares are independent of the cause of the legal invalidity of the transfer. In other words, the same circumstances will raise an estoppel though the transfer may be invalid for entirely different reasons. To be sure, some circumstances sufficient to raise an estoppel can only arise in case of some particular kind of invalid transfers — blank transfers wrongfully filled up, forged transfers, or altered transfers —

¹ *Leavitt v. Fisher*, 4 Duer (N. Y.)

² *Infra*, § 893 et seq.

1. Cf. *Kern's Estate*, 176 Pa. St. 373; 35 Atl. 231.

and these will necessarily be separately considered. At the outset, however, we should investigate the general principles as to what will and what will not be grounds for estoppel against the true owner in any case of a void transfer. Unfortunately, the decided cases which deal with these general principles are rare.

A shareholder who as member of the board of directors approves a transfer of shares, the denoting numbers of which stated in the transfer are the same as those of shares which he himself owns, is not by that circumstance estopped from setting up his own title in opposition to that of the transferee:¹ every director could not be expected to examine personally the register of shareholders in order to learn whether a person who has executed a transfer and presented it to the directors for their approval is the registered owner of the shares which he assumes to transfer. The fact that an officer of the company receives payment of a call or assessment upon certain shares, to which he claims title, from a person claiming the shares adversely will not preclude the officer from proving that he has a better title than the adverse claimant.²

§ 892. *Estoppel precluded by Negligence of Transferee.* — Any circumstance sufficiently suspicious to deter a reasonably cautious man from accepting a transfer will prevent an estoppel to dispute the validity of the transfer from arising in favor of one who has acted upon it. Thus, the fact that a transfer was executed many years before is a suspicious circumstance.³ So, a transfer of a share-certificate for much less than the value of the shares by a lad sixteen years old should put a purchaser on inquiry.⁴

§ 893-§ 903. TRANSFERS IN BLANK.

§ 893. *Statement of Problem.* — Questions as to an estoppel of the true owner of shares to deny the validity of a void or unauthorized transfer often arise where the common practice is followed of signing a transfer of shares in blank.

¹ *Dixon v. Kennaway & Co.* (1900), 1 Ch. 833.

² *Pennsylvania R. R. Co.'s Appeal*, 86 Pa. St. 80 (but, note that in this case the estoppel was upheld).

³ *Shaw v. Spencer*, 100 Mass. 382, 394-395; 97 Am. Dec. 107; 1 Am. Rep. 115.

⁴ *Anderson v. Nicholas*, 28 N. Y. 600.

Of course, blanks may be of various kinds and degrees. For instance, a blank may be left for some immaterial term; or on the other hand a person may sign an entirely blank sheet of paper, leaving the whole instrument to be filled in above the signature. Usually, however, when we speak of a transfer of shares in blank, we mean a transfer in which a blank is left for the name of the transferee but which with that exception is complete. The first question is, what actual authority to fill up the blank did the transferor intend to confer and upon whom did he intend to confer it; but this, as we have seen above, is a question which cannot be answered from the face of the instrument. The principle of estoppel need be invoked only when the actual authority is exceeded. Whether the transferor should be estopped is a question which depends very largely on the state of the instrument when he signed it, and upon the inferences which might fairly be drawn from the face of the paper as executed. If the only blank is for the name of the transferee, the inference might reasonably be drawn that the transferor intended to authorize any person into whose hands the instrument might lawfully come to fill up the blank with his own name:¹ for such is the mercantile custom. If, however, a blank is left for the number of shares transferred, or for the name of the company, or for any other matter of similar importance, any such inference would be unwarrantable, and the only justifiable conclusion would be that the transferor intended either to fill up the blanks himself or to confer a special authority to do so upon some particular person.

If the blanks are filled up in pursuance of the transferor's actual authority and directions, there can of course be no question but that the transfer is thenceforward valid and effectual (apart from any technical difficulties that might be encountered if the transfer were under seal). The question we are now to consider is whether by emitting an instrument in an incomplete state, the transferor can be estopped from asserting that the blanks were filled up without his authority.

§ 894. **English Doctrine.** — By a series of decisions in England, following certain earlier English cases as to bills of exchange and promissory notes, the law in that country seems to

¹ *Leavitt v. Fisher*, 4 Duer (N. 283; 53 N. E. 590. See also *infra*, Y.) 1; *Coffey v. Coffey*, 179 Ill. § 896.

have become settled that a person who takes a transfer of shares in which a blank is left for the consideration, date, name of transferee, or any other material term, must at his peril ascertain the authority of the person from whom he takes the transfer to fill up the blanks.¹ This is true, although the jury find that the transferor was negligent in leaving the blanks and that the purchaser acted as a reasonable man in advancing his money upon the faith of the transfer.²

§ 895. *Criticism of English Doctrine.* — It is submitted that these decisions are unfortunate in failing to discriminate between different sorts of blanks. For instance, if a person signs a transfer of shares leaving the name of the company blank — and such a thing is quite possible in England where transfers are not, as usually with us, endorsed upon the share-certificates — anybody who takes the transfer in that condition might well be chargeable with constructive notice of any limitations imposed by the transferor upon the right to fill up the blank. Any blank of such sort is a suspicious circumstance.³ On the other hand, where the only material blank is a blank for the name of the transferee — and blanks for the consideration, date, etc., are not material blanks — the instrument is in accordance with the custom of stock brokers and does not, and should not excite the least suspicion. Accordingly, it is submitted that any rule of law charging a person who advances money on the faith of such a transfer with constructive notice of any limitations imposed by the transferor upon the right to fill up the blank is without justification in reason.

§ 896. *American Doctrine.* — Accordingly, the American cases almost with unanimity hold that a person who signs and delivers a transfer, endorsed upon the share-certificate, leaving a blank for the name of the transferee, is taken impliedly to authorize any *bona fide* holder of the certificate and transfer to fill up the blank with his own name or that of any person whom

¹ *France v. Clark*, 26 Ch. D. 257 (*Clark* was so seriously shaken by criticising and explaining *Ex parte Sargent*, 17 Eq. 273); *Fox v. Martin*, 64 L. J. Ch. 473. the opinions of the lords in *Colonial Bank v. Cady* as to be no longer an authority).

But see *Colonial Bank v. Cady*, 15 A. C. 267, 278, 286; *Colonial Bank v. Hepworth*, 36 Ch. D. 36; *Smith v. Rogers*, 30 Ont. 256 (where the judges thought that *France v.* ² *Hutchinson v. Colorado United Mining Co.*, 3 Times L. R. 265. ³ Cf. *Treadwell v. Clark*, 114 N. Y. App. Div. 493; 100 N. Y. Supp. 1, affirmed, 82 N. E. 505.

he may select; and if any restrictions or conditions which the transferor may have imposed upon the right to negotiate the certificate and transfer are disregarded, the transferor will be estopped from denying the right of any *bona fide* purchaser of the instrument to fill out the blank, and have the transfer registered.¹ If, however, the holder of the blank transfer does not claim to be owner of the shares but represents himself as agent of the owner and authorized to negotiate a loan on the owner's behalf on the security of the shares, a lender taking the shares as collateral upon the faith of those representations will not, it has been held in New York, be entitled to hold the shares as against the true owner unless the latter had in fact given authority to the holder of the transfer to pledge the shares;² but the distinction thus taken is certainly a very fine one, and is perhaps of questionable soundness. If the *bona fide* holder takes as security for a debt, the defrauded owner of the shares has a right to insist that any other security which the *bona fide* holder may have should be exhausted before the shares in question are resorted to.³

¹ *National, etc. Trust Co. v. Gray*, 12 D. C. App. Cas. 276; *Brittan v. Oakland Bank of Savings*, 124 Cal. 282; 57 Pac. 84; 71 Am. St. Rep. 58; *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325; 70 Am. Rep. 341; *Mount Holly, etc. Co. v. Ferree*, 17 N. J. Eq. 117; *Prall v. Tilt*, 28 N. J. Eq. 479; *Otis v. Gardner*, 105 Ill. 436; *State Bank v. Cox*, 11 Rich. Eq. (S. Car.) 344; *Wood's Appeal*, 92 Pa. St. 379; 37 Am. Rep. 694; *Burton's Appeal*, 93 Pa. St. 214; *Cherry v. Frost*, 7 Lea (Tenn.) 1; *Fatman v. Lobach*, 1 Duer (N. Y.) 354; *Walker v. Detroit Transit Ry. Co.*, 47 Mich. 338; 11 N. W. 187; *Jarvis v. Rogers*, 13 Mass. 105; *Gilbert v. Erie Bldg. Ass'n*, 184 Pa. St. 554; 39 Atl. 291; *Westinghouse v. German National Bank*, 196 Pa. St. 249; 46 Atl. 380; *Nelson v. Owen*, 113 Ala. 372; 21 So. 75; *Strange v. Houston, etc. R. R. Co.*, 53 Texas 162, 170-171; *O'Mara v. Newcomb* (Colo.), 88 Pac. 167; *Beckwith v. Gallice Mines Co.* (Oreg.),

93 Pac. 453 (where the certificate and transfer were delivered to a bank to be delivered to a purchaser on payment of the purchase money).

In Ontario, the American doctrine has been followed upon the ground that by the usage of the stock exchange the transfer in blank is recognized as authorizing any holder to fill in his own name as transferee. *Smith v. Rogers*, 30 Ont. R. 256.

On the other hand, in Maryland the English doctrine has been followed. *Taliaferro v. First Nat. Bank*, 71 Md. 200, 213-214; *First Nat. Bank v. Taliaferro*, 72 Md. 164; *German Sav. Bank v. Renshaw*, 78 Md. 475. Cf. *Kern's Estate*, 176 Pa. St. 373 (headnote inadequate); 35 Atl. 231.

² *Merchants' Bank v. Livingston*, 74 N. Y. 223. Compare also Maryland cases cited in last note.

³ *Smith v. Savin*, 141 N. Y. 315; 36 N. E. 338. Cf. *Denny v. Lyon*, 38 Pa. St. 98; 80 Am. Dec. 463.

§ 897. **No Estoppel where Share-Certificate retained by Transferor.** — If the transferor retains the share-certificate in his own possession, the doctrine of estoppel cannot be relied upon to eke out the actual authority which he intended to confer to fill up blanks in the transfer.¹ By retaining the indicia of ownership, he in effect warns everybody into whose hands the transfer may come to be on his guard against accepting the transfer as equivalent to the shares. This principle is supported by the authority of an English decision, and would *a fortiori* be accepted as law in the United States where a transfer of shares separated from the certificate is more unusual and would certainly never be relied upon by any one but a reckless speculator.

§ 898. **No Estoppel unless Transfer regular on its Face.** — If the transferor instead of signing his name at the foot or end of the printed form on the back of the share-certificate signs in the blank left at the beginning of the printed form for the name of the transferor, the transfer is not in order and will not be sufficient to raise an estoppel against the transferor.² A transfer in order to raise an estoppel must be regular on its face.³

§ 899. **Alteration of Transfer after the Blank is filled up.** — If a blank for the name of a transferee is once filled up, the power is exhausted; and any subsequent change in the name is an unauthorized alteration and makes the instrument tantamount to a forgery.⁴

§ 900. **Transfer in Blank by Executors.** — If executors of a deceased shareholder execute in their own names upon the back of their testator's share-certificate a transfer in blank in the ordinary American form, the House of Lords held, in a case relating to shares in an American company, that their action is open to two constructions. They may have executed the transfer either for the purpose of selling and disposing of the shares or merely for the purpose of having the shares put in their own names as executors; and on account of this ambiguity, it was held that if in fact the transfer was signed by the executors for the purpose of having themselves registered as owners and if

¹ *Swan v. North British Australasian Co.*, 2 H. & C. 175.

² See also *infra*, § 900. Cf. *Taliaferro v. First Nat. Bank*, 71 Md.

³ *Treadwell v. Clark*, 114 N. Y. App. Div. 493; 100 N. Y. Supp. 1, affirmed, 82 N. E. 505.

200, 211-212.

⁴ *Denny v. Lyon*, 38 Pa. St. 98; 80 Am. Dec. 463. See *infra*, § 907.

the broker wrongfully disposed of the certificate and blank transfer to a *bona fide* purchaser, yet the executors ought not to be estopped from denying the right of the purchaser to fill in his own name as transferee and to have himself registered as shareholder.¹ This conclusion was reached, although several members of the House expressed an emphatic opinion which is difficult to reconcile with the English cases cited above,² that if the share-certificate had been made out in the names of the persons who signed the blank transfer endorsed thereon, they would have been estopped. The decision was rested exclusively upon the circumstance that the persons who signed the transfer were executors of the registered shareholder. Nevertheless, it may be doubted whether that circumstance should upon principle affect the application of the doctrine of estoppel. Whilst the action of the executors was consistent either with an intention to transfer the shares or with an intention to procure registration of the shares in their own names, yet if the latter was their real intention, was it not their duty (if they wished to protect themselves from estoppel) to fill in their own names as transferees instead of leaving a blank? The American cases upon the point are not very full or numerous, but so far as they go, they are not in harmony with the decision of the House of Lords in *Colonial Bank v. Cady*.³ Another circumstance which was thought by some of the lords to prevent an estoppel from being raised was the fact that a certificate of grant of letters testamentary was not attached to the share-certificate, so that according to the rules of the stock exchange both in London and New York the instrument would not pass from hand to hand, being regarded as incomplete and not "in order."⁴

§ 901. **Transfer in Blank by Guardians.** — A transfer in blank by a guardian, the shares standing in the name of the ward, has been thought to have no effect by way of estopping the ward from denying his right or power to dispose of the

¹ *Colonial Bank v. Cady*, 15 A. C. 267. While the House decided that the question of estoppel should be determined according to English law, yet they expressed the opinion that the American law did not differ from the law of England. 15 A. C. 272, 277, 282, 285.

² *Supra*, § 894.

³ *Prall v. Tilt*, 28 N. J. Eq. 479; *Wood's Appeal*, 92 Pa. St. 379; 37 Am. Rep. 694.

⁴ See particularly judgment of Lord Morris, 15 A. C. 287-288. Cf. *supra*, § 898.

shares;¹ for, it was said, the signature of a fiduciary should put any subsequent holder on his inquiry as to the fiduciary's authority.

§ 902-§ 903. *Theft of Certificate endorsed with
Transfer in Blank.*

§ 902. **Theft from Transferor before Delivery to Transferee.** — If a transfer in blank is endorsed upon a share-certificate and then before any delivery thereof the certificate with the transfer is lost or stolen and sold to a *bona fide* purchaser, the right of the latter to the shares depends upon whether or not the owner had by negligence of any kind enabled the theft to be committed. If he had locked the certificate with the endorsed blank transfer in his strong-box which the thief had broken open, it would be difficult to say that the owner had been guilty of any negligence upon which to build an estoppel. And, accordingly, in such a case, where the owner of the certificate has been as careful of it as reasonable convenience admits and reasonable prudence dictates, he, the original owner, would have a better title than the *bona fide* purchaser.² If, however, the owner had carelessly left the endorsed certificate in some public place, he would (at least in America) be held estopped by his negligence, so that the purchaser would get a good title. But the mere fact that he leaves the endorsed certificate in a safe-deposit box to which some other person as well as himself has access will not estop him from asserting his ownership if that other person steals the certificate and assigns it to a *bona fide* purchaser.³ Even the fact that the true owner had introduced the thief to the person who afterwards purchased the certificate from him and had recommended him as trustworthy has been held in-

¹ *O'Herron v. Gray*, 168 Mass. 573; Oh. St. 367; 64 N. E. 518; 90 Am. 47 N. E. 429; 60 Am. St. Rep. 411; St. Rep. 586; 58 L. R. A. 620 (where the certificate endorsed in blank was

² *Biddle v. Bayard*, 13 Pa. St. 150; *Sherwood v. Meadow Valley Mining Co.*, 50 Cal. 412; *Barstow v. Savage Min. Co.*, 64 Cal. 388; 1 Pac. 349; 49 Am. Rep. 705; *Anderson v. Nicholas*, 28 N. Y. 600; *Farmers' Bank v. Diebold Safe, etc. Co.*, 66

³ *Bangor El. Light, etc. Co. v. Robinson*, 52 Fed. 520.

sufficient to raise an estoppel.¹ On the other hand, where the endorsed certificates were intrusted for safekeeping to an agent by whom they were fraudulently transferred, the owner has been held to be estopped.²

§ 903. **Theft from Transferee or subsequent Holder.** — If, after a blank transfer is endorsed upon a share-certificate and *after* the instrument so endorsed is delivered to the transferee, the certificate is stolen from the transferee and by the thief sold to a *bona fide* purchaser, there might be difficulty in determining whether the first transferee or the purchaser has the better title. So far as the original transferor is concerned, it is a matter of indifference. If the certificates were strictly negotiable, like a promissory note payable to bearer, there would be no difficulty. But as the certificates lack this technical negotiability, the transferee, if he has not been guilty of any negligence, has a superior title to that of the purchaser.³ For example, where shares stand in the name of brokers, as trustees for their customer, the latter in sending a messenger for the share-certificate does not authorize the brokers to deliver it to the messenger in such a form that he may have the power to convert it to his own use; and therefore if the brokers deliver the certificate to the messenger with a transfer in blank endorsed thereon in the usual form, and if the certificate is sold by the messenger for his own account, the person to whom he sells it is liable to the true owner for a conversion.⁴

§ 904-§ 906. *Forged Transfers.*

§ 904. **In general.** — A forged transfer so far as any efficacy in passing title *proprio vigore* is concerned is equivalent to no transfer at all.⁵

¹ *Bangor El. Light, etc. Co. v. Smith v. Prosser* (1907), 2 K. B. 735 *Robinson*, 52 Fed. 520 (headnote (as to a promissory note) inadequate).

² *Pennsylvania R. R. Co.'s Appeal*, 86 Pa. St. 80; *Shattuck v. American Cement Co.*, 205 Pa. St. 197; 54 Atl. 785; 97 Am. St. Rep. 735. ³ *East Birmingham Land Co. v. Dennis*, 85 Ala. 565; 5 So. 317; 7 Am. St. Rep. 73; 2 L. R. A. 836. ⁴ *Hall v. Wagner*, 111 N. Y. App. Div. 70; 97 N. Y. Supp. 570.

Quare, whether these decisions would be followed in other states. Cf. *Hall v. Wagner*, 111 N. Y. App. Div. 70, 75-76; 97 N. Y. Supp. 570; *Barton v. North Staffordshire Ry. Co.*, 38 Ch. D. 458; *Barton v. London, etc. Ry. Co.*, 24 Q. B. D. 77; *Telegraph Co. v. Davenport*, 97 U. S.

§ 905. **Negligence of Person whose Name is forged.** — If the title of any person claiming under a forged transfer is to be upheld, that result can only be reached because the circumstances are such as to estop the true owner from asserting that his signature is forged.¹ Ordinarily, considerable difficulty is encountered in raising an estoppel to deny the validity of a title derived through a forgery. Certainly, the mere fact that the owner intrusted the certificate to the forger and thus in a sense made the crime possible is not sufficient to estop him from setting up his title, even to the prejudice of a *bona fide* purchaser,² even though the custodian was known to the owner to be insolvent and to have previously used without authority funds not belonging to him.³ So, the fact that a corporation which owns stock intrusts its seal to an officer who without authority affixes the seal to a power of attorney to transfer the stock does not estop the corporation from denying the validity of a transfer executed in pursuance of the power of attorney.⁴ So, where, as is often done in England, the corporation upon receiving for registration a transfer purporting to be signed by the registered owner writes a letter of inquiry to the latter in order to ascertain whether the transfer is good, nevertheless the owner is not estopped from asserting that the transfer was forged, although he neglected to reply to the letter of inquiry, thus losing an opportunity of deterring the company from registering the transfer.⁵ The negligence of a guardian in regard to the prevention or detection of a forgery cannot estop the ward.⁶

§ 906. **Adoption of forged Signature by Transferor.** — A forged transfer may be adopted by the person whose name is forged, and the signature then becomes by adoption the genuine signature of the transferor.⁷ But such a ratification will not be

369; *Chicago Edison Co. v. Fay*, 164 Ill. 323; 45 N. E. 534; *Hildyard v. South Sea Co.*, 2 P. Wms. 76; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; 20 Am. Rep. 90.

¹ As to rights of person claiming under a forged transfer through an estoppel of the corporation to deny his title, see *infra*, § 908 et seq.

² Cf. *Bahia & San Francisco Ry. Co.*, L. R. 3 Q. B. 584; *Johnston v. Renton*, 9 Eq. 181.

³ *Telegraph Co. v. Davenport*, 97 U. S. 369 (headnote inadequate).

⁴ *Bank of Ireland v. Trustees of Evans' Charities*, 5 H. L. Cas. 389; *Mayor, etc. of Merchants of the Staple v. Bank of England*, 21 Q. B. D. 160.

⁵ *Barton v. London, etc. Ry. Co.*, 24 Q. B. D. 77.

⁶ *Telegraph Co. v. Davenport*, 97 U. S. 369.

⁷ *Coles v. Bank of England*, 10 Ad. & E. 437, explained and doubted

implied from doubtful evidence.¹ Thus, where the forger deposits the purchase money to the credit of the transferor in a bank upon which he is authorized to draw cheques in the name of the transferor, and does draw out sums in excess of the amount realized upon the forged transfer, there was held to be no sufficient evidence of ratification of the forged transfer.²

§ 907. **Altered Transfers.** — A transfer of shares which is altered in any material particular without the transferor's authority is in its altered form substantially a forged transfer,³ and subject to the same rules. If the transfer is altered by the transferor without the transferee's consent, it would nevertheless have the same effect as if a second transfer had been executed by the transferor;⁴ but if such altered transfer is to a person who either from the state of the document or otherwise has notice of the alteration, the rights of the first transferee are clearly superior.⁵

§ 908-§ 923. *ESTOPPEL OF COMPANY TO DENY TITLE OF PERSON CLAIMING UNDER A VOID TRANSFER.*

§ 908. **Existence of Estoppel independent of Cause of Invalidity of Transfer.** — Very valuable rights may be acquired through a void transfer, where, although the true owner is not estopped from claiming his shares, yet the company is for some reason estopped from denying the transferee's title.⁶ The grounds for such an estoppel are generally if not always quite independent

in *Bank of Ireland v. Trustees of Evans' Charities*, 5 H. L. Cas. 389, after blanks have once been filled up, see supra, § 899.

411, 414, 415.

¹ *Chicago Edison Co. v. Fay*, 164 Ill. 323; 45 N. E. 534. ⁴ *Eaton v. New England Telegraph Co.*, 68 Me. 63, 68 (semble).

² *Chicago Edison Co. v. Fay*, 164 Ill. 323; 45 N. E. 534. ⁵ *Eaton v. New England Telegraph Co.*, 68 Me. 63.

³ *Hare v. L. & N. W. Ry. Co.*, Johns. 722; *Sewall v. Boston Water Power Co.*, 4 Allen (Mass.) 277; 81 Am. Dec. 701. ⁶ As to estoppel of the corporation to treat shares in the hands of a transferee as not fully paid up, see supra, § 800.

As to alteration of blank transfer

of the cause of the invalidity of the transfer — lack of title in the transferor, forgery, or any other cause. Hence, in determining whether the company is estopped from denying the title of a person claiming under a void transfer, there is no occasion to inquire how the transfer came to be invalid.

§ 909—§ 921. ESTOPPEL BY ISSUE OF SHARE-CERTIFICATE.

§ 909. **In general.** — The circumstance usually seized upon to raise such an estoppel against the company is the issue of a share-certificate to the transferor. A certificate is a solemn assertion under the corporate seal that the person named therein is entitled to the specified number of shares. This representation is made for the purpose of being acted upon, and if a person does act upon it, for instance, by purchasing the holder's supposed rights, the company is estopped from asserting that the representation was false and that the certificate holder had in fact no title, either because he claimed under an invalid transfer or for any other reason.¹ If the company possesses unissued shares, it may doubtless be required to make good its representation by issuing them to the holder of the certificate or his transferee.² If the entire authorized capital has been already issued, then the company cannot be compelled to issue the shares which the certificate represents;³ but the estoppel exists nevertheless,⁴ so that if the company cancels the entry of the certificate

¹ *Bahia & San Francisco Ry. Co.*, Mass. 547; 24 N. E. 914; 8 L. R. A. L. R. 3 Q. B. 584; *Ottos Kopje Diamond Mines* (1893), 1 Ch. 618; *Shaw*

v. Port Philip Mining Co., 13 Q. B. D. 103; *Bank of Kentucky v. Schuylkill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 249–250; *Philadelphia Nat. Bank v. Smith*, 195 Pa. St. 38; 45 Atl. 655; *Fifth Avenue Bank v. Forty-second Street, etc. R. R. Co.*, 137 N. Y. 231; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331; *Daily Telegraph Newspaper Co. v. Cohen*, 5 N. So. Wales State Rep. 520; *Westminster Nat. Bank v. New England Electric Works*, 62 Atl. 971; 73 N. H. 465; 111 Am. St. Rep. 637.

In addition, the officers who issued the certificate may be liable for deceit. *Windram v. French*, 151

² *Bank of Kentucky v. Schuylkill Bank*, 1 Pars. Eq. Cas. (Pa.) 180, 249 (semble); *Westminster Nat. Bank v. New England Electric Works*, 62 Atl. 971; 73 N. H. 465; 111 Am. St. Rep. 637.

³ *Allen v. South Boston R. R. Co.*, 150 Mass. 200, 207; 22 N. E. 917; 15 Am. St. Rep. 185; 5 L. R. A. 716; *First Ave. Land Co. v. Parker*, 111 Wisc. 1; 86 N. W. 604; 87 Am. St. Rep. 841.

But see *Machinists' Nat. Bank v. Field*, 126 Mass. 345 (headnote misleading).

⁴ *Balkis Consolidated Co. v. Tomkinson* (1893), A. C. 396, 410.

Cf. *Bridgeport Bank v. New York*,

holder's name among its shareholders (as it must do at the instance of the true owner of the shares), then the transferee from the person to whom the certificate was issued is entitled to treat such action as a conversion and recover from the company the value of the shares.¹ In such a case the certificate holder is entitled to retain any dividends which may have been paid to him by the company.² The company is, however, entitled to the same rights that it would have had if the shares had been valid, and therefore if it be entitled to a lien on its shares for debts of the holders, it is entitled to set off or recoup out of the sum payable as damages the amount of any debt for which it would have had a lien if the shares purporting to be represented by the certificate had had a legal existence.³

§ 910. **Whether Certificate estops Company from asserting that Holder has lost his Title by Transfer or otherwise after Issue of Certificate.** — The estoppel created by the issue of a share-certificate precludes the company from denying that the person named in the certificate was entitled to the shares at the time of the issue of the certificate: it may not in all cases prevent the company from showing that the title, although good at that time, subsequently became invalid. Suppose, for instance, the holder of the certificate, having a good title, transfers the shares by a duly registered transfer to some other person, but is permitted by the

etc. R. R. Co., 30 Conn. 231; *Bank of Kentucky v. Schuylkill Bank*, 1 Pars. Eq. Cas. 180, 245 et seq.; *Willis v. Philadelphia, etc. R. R. Co.*, 6 Wkly. N. Cas. (Pa.) 461; *Am. Exch. Nat. Bank v. Woodlawn Cemetery*, 105 N. Y. Supp. 305 (holding also that the fact that the several certificates presented to a transferee were not consecutively numbered, was not sufficient to charge him with notice of an overissue).

¹ *Bahia & San Francisco Ry. Co.*, L. R. 3 Q. B. 584; *Ottos Kopje Diamond Mines* (1893), 1 Ch. 618; *Shaw v. Port Philip Mining Co.*, 13 Q. B. D. 103; *Mount Holly Paper Co.'s Appeal*, 99 Pa. St. 513, 521 (headnote inadequate); *Allen v. South Boston R. R. Co.*, 150 Mass. 200, 207; 22 N. E. 917; 15 Am. St. Rep. 185; 5 L. R. A. 716; *Havens v. Bank of*

Tarboro, 132 N. Car. 214; 43 S. E. 639; 95 Am. St. Rep. 627; *Daily Telegraph Newspaper Co. v. Cohen*, 5 N. So. Wales State Rep. 520 (holding that where the shares have increased in value, the measure of damages is the value at the time the company first refused to recognize plaintiff as shareholder).

Cf. *First Ave. Land Co. v. Parker*, 111 Wisc. 1; 86 N. W. 604; 87 Am. St. Rep. 841.

But see contra: *Mechanics' Bank v. N. Y., etc. R. R. Co.*, 13 N. Y. 599 (distinguished in *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30).

² *Daily Telegraph Newspaper Co. v. Cohen*, 5 N. So. Wales State Rep. 520.

³ *Mount Holly Paper Co.'s Appeal*, 99 Pa. St. 513 (headnote inadequate).

company to retain the certificate. If he, being still possessed of the indicia of ownership, executes a transfer to some other person to whom the certificate is delivered and who pays his money in reliance upon the certificate, is the company estopped from denying the title of this second transferee? In order that such an estoppel should be raised, it is necessary to show that the company was guilty of some negligence or breach of duty. If the shares are, as is usually the case, at least in America, expressed to be transferable only upon surrender of the certificate, the registration of the first transfer without requiring the transferor to surrender the certificate would seem to be sufficient to charge the company with a continuing representation that the transferor remained entitled to the shares represented by the certificate, so that the company should be estopped from denying the title of the second transferee,¹ or from denying the title of a transferee to whom the certificate had been delivered before the registration of the other transfer.² At all events, this result should be reached unless the company had reasonable ground to suppose that the certificate had been destroyed.

Nevertheless, the opposite conclusion was recently reached by the English Court of Appeal, which held that under such cir-

¹ *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365; 32 Am. Rep. 506.

315; *Bank v. Lanier*, 11 Wall. 369; *Strange v. Houston, etc. R. R. Co.*, 53 Tex. 162; *Greenleaf v. Ludington*, 15 Wisc. 558; 82 Am. Dec. 698; *Supply Ditch Co. v. Elliott*, 10 Colo. 327; 15 Pac. 691; 3 Am. St. Rep. 586.

But see *Bank of Commerce v. Bank of Newport*, 63 Fed. 898, 902 (headnote misleading); 11 C. C. A. 484.

² *Cleveland, etc. R. R. Co. v. Robbins*, 35 Oh. St. 483; *Factors, etc. Ins. Co. v. Marine Dry Dock, etc. Co.*, 31 La. Ann. 149; *Brisbane v. Delaware, etc. R. R. Co.*, 94 N. Y. 204; *First Nat. Bank v. Stribling*, 16 Okl. 41; 86 Pac. 512.

As to the effect of the issue of a new certificate to the transferor in pursuance of judicial proceedings presupposing that the original certificate had been lost, see *Downing*

v. Thompson, 103 Va. 58; 48 S. E. 506.

³ *Colonial Bank v. Whinney*, 11 A. C. 426, 437-438, per Lord Blackburn.

Cf. *Strange v. Houston, etc. R. R. Co.*, 53 Tex. 162, 168; *Greenleaf v. Ludington*, 15 Wisc. 558; 82 Am. Dec. 698; *Guilford v. Western Union Tel. Co.*, 59 Minn. 332; 61 N. W. 324; 50 Am. St. Rep. 407 (where the certificate had been lost for twelve years); *Cleveland, etc. R. R. Co. v. Robbins*, 35 Oh. St. 483 (where the fact that the transfer had been registered and a new certificate issued in pursuance of a by-law to replace a certificate which was supposed to be lost was thought to make no difference in the company's liability); *Pottsville Bank v. Minersville Water Co.*, 211 Pa. 566; 61 Atl. 119 (where the first transferee and holder of the certificate was held to be barred by laches).

cumstances no estoppel should be raised against the company.¹ It is submitted that this decision is narrow, and unsuited to modern commercial conditions. The precise ground for the estoppel which has been suggested above does not seem to have been called to the attention of the court, the contention of counsel being that the company was estopped by a "certification"² of the first transfer — a contention which the judgments of the learned judges answer very clearly and conclusively.

As stated above, the true doctrine would seem to be that an outstanding certificate is a continuing representation on the company's part that the person named therein is holder of the shares represented thereby;³ and that this representation continues until the certificate is cancelled or surrendered, or until its remaining in circulation can no longer be attributed to the company. Thus, even a decree against the certificate holder declaring him to hold the shares in trust will not prevent the company from being estopped to deny the title of a subsequent *bona fide* purchaser taking the certificate from the trustee;⁴ and hence the court will not enter such a decree without first securing a surrender of the certificate.⁵ On the other hand, it has been held that where shares are sold under a decree of a court of equity passed in a case to which the holder is party, the company is not bound to recognize the title of a purchaser who subsequently obtains the certificate from the holder, without notice of the judicial sale.⁶

§ 911. **Certificate issued to Fictitious Person.** — A share-

¹ *Longman v. Bath Electric Tramways* (1905), 1 Ch. 646. Cf. *Rainford v. James Keith & Blackman Co.* (1905), 1 Ch. 296 (reversed on another point in S. C. (1905), 2 Ch. 147. An earlier Ontario case is in accord with the English law as established by *Longman v. Bath Electric Tramways*. *Smith v. Walkerville Malleable Iron Co.*, 23 Ont. App. 95.

² As to what is "certification" of a transfer, see *supra*, § 869.

³ *Joslyn v. St. Paul Distilling Co.*, 44 Minn. 183; 46 N. W. 337; *Strange v. Houston, etc. R. R. Co.*, 53 Tex. 162, 168.

But see *Bank of Commerce v. Bank of Newport*, 63 Fed. 898, 902

(headnote misleading); 11 C. C. A. 484; *Guilford v. Western Union Tel. Co.*, 59 Minn. 332, 345-346; 61 N. W. 324; 50 Am. St. Rep. 407.

⁴ *Holbrook v. New Jersey Zinc Co.*, 57 N. Y. 616; *Joslyn v. St. Paul Distilling Co.*, 44 Minn. 183; 46 N. W. 337.

Cf. *Bean v. Am. L. & T. Co.*, 122 N. Y. 622; 26 N. E. 11.

⁵ *Joslyn v. St. Paul Distilling Co.*, 44 Minn. 183; 46 N. W. 337.

⁶ *Sprague v. Cocheco Mfg. Co.*, 10 Blatchf. 173.

Cf. *Printing Telegraph News Co. v. Brantingham*, 77 N. Y. App. Div. 280; 72 N. Y. Supp. 190.

certificate impliedly represents that the person named therein as shareholder is a real person, and the company is therefore estopped from asserting him to be fictitious. Hence, it has been thought that a certificate made out in favor of a fictitious person is in effect the same as if it represented the bearer to be the owner of the shares.¹ This notion is based on analogy to the law of bills and notes, by which an instrument payable to a fictitious payee is deemed payable to bearer; but inasmuch as corporations usually have no power to issue share-certificates payable to bearer,² the analogy is far from complete.

§ 912-§ 916. *In whose Favor Estoppel will be raised.*

§ 912. **Only in favor of Transferee who relied and acted reasonably in relying upon the Certificate.** — A transferee of a certificate cannot claim title by estoppel to the shares purporting to be represented thereby unless he was actually led by the certificate to believe that his transferor's title was good, nor unless he acted reasonably in so believing. But a transferee is not negligent who relies upon the company's representation as expressed in the certificate, and therefore makes no inquiries at the company's office; and hence such a transferee can enforce the estoppel against the company even though the inquiries, if he had made them, would have disclosed the defect in title.³ Moreover, the estoppel arises even in favor of a transferee who had knowledge of a doubt as to the title of his transferor;⁴ for he had a right to infer that the company before issuing a certificate to the transferor had considered all such doubts and found them baseless. An officer or director of the company whose duty it was to know of the invalidity of the share-certificate will not be allowed as transferee thereof to claim title to the shares as against the company by estoppel.⁵

¹ *Jarvis v. Manhattan Beach Co.*, *Third Nat. Bank*, 1 Oh. Circ. Ct. 53; Hun (N. Y.) 362, 365; 6 N. Y. 199).
 Supp. 703, affirmed, 148 N. Y. 652; Cf. *Allen v. South Boston R. R.*
 43 N. E. 68; 31 L. R. A. 776; 51 *Co.*, 150 Mass. 200; 22 N. E. 917;
 Am. St. Rep. 727. 15 Am. St. Rep. 185; 5 L. R. A. 716.

² *Supra*, § 852.

⁴ *Mandelbaum v. North American*

³ *Cincinnati, etc. Ry. Co. v. Citizens Nat. Bank*, 56 Oh. St. 351; 47 *Mining Co.*, 4 Mich. 465.
 N. E. 249; 43 L. R. A. 777 (over-⁵ *Houston, etc. Ry. Co. v. Van*
 ruling *Cincinnati, etc. Ry. Co. v. Alstyne*, 56 Tex. 439. But cf. *infra*,
 § 1538, § 1540.

§ 913. **Mere Volunteers.** — The estoppel will not be raised in favor of a mere volunteer. Hence, inasmuch as share-certificates are not negotiable instruments, a transferee who takes the certificate as collateral security for an antecedent debt cannot claim the rights of holder for value, and therefore cannot hold the company estopped from denying his title.¹ Moreover, he must actually have given value; it is not enough that he may have agreed to do so by a contract which he can rescind for failure of consideration if the title to the shares is not good.² On the other hand, a volunteer claiming through a person whose title the company was estopped from denying succeeds to the rights of his predecessor in title.

§ 914. **Estoppel in Favor of Person to whom Certificate was issued** — *When it will not be raised.* — The estoppel raised against a corporation by its issue of a share-certificate to a person who is not legally entitled to the shares which the certificate purports to represent can in general be invoked only by some transferee from the person to whom the certificate is issued and not by that person himself.³ Only in exceptional cases can the person named in the certificate be proved to have altered his position in reliance upon the representation contained in the certificate; and, therefore, in most cases a necessary prerequisite to an estoppel *in pais* is lacking. The certificate holder's loss is not occasioned by the company's representation. For instance, if a corporation issues a share-certificate to a person who presents a forged transfer for registration, and the certificate holder pledges the certificate as collateral for a loan, the company

¹ *Kisterbock's Appeal*, 127 Pa. St. 601; 18 Atl. 381; 14 Am. St. Rep. 868. Cf. *supra*, § 843, and *Miller v. Houston City Ry. Co.*, 69 Fed. 63; 16 C. C. A. 128 (where the certificate was deposited as margin on a purchase of cotton for future delivery).

² *Hayden v. Charter Oak Driving Park*, 63 Conn. 142; 27 Atl. 232.

³ *Houston, etc. Ry. Co. v. Van Alstyne*, 56 Tex. 439; *Trimble v. Union Nat. Bank*, 71 Mo. App. 467; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; 20 Am. Rep. 90; *Wright's Appeal*, 99 Pa. St. 425; *Moore v. Citizens' Nat. Bank*, 111 U. S. 156;

4 Sup. Ct. 345. Cf. *Lucile Dreyfus Mining Co. v. Willard* (Wash.), 89 Pac. 935.

But see *Allen v. South Boston R. R. Co.*, 150 Mass. 200; 22 N. E. 917; 15 Am. St. Rep. 185; 5 L. R. A. 716.

As to whether the company can maintain a bill in equity to cancel a certificate on the ground of the liability which might be created by transferring the same to a *bona fide* purchaser, see *Reno Oil Co. v. Culver*, 69 N. Y. Supp. 969; 60 N. Y. App. Div. 129.

would be estopped from denying the title of the pledgee;¹ but if the loan is paid off so that the unincumbered title revests in the pledgor, the estoppel is at an end,² for *he* had not been misled by any representation of the company. It would be different if the person to whom the certificate was issued first sold the shares to a *bona fide* purchaser and then bought them back. In that case he would succeed to the purchaser's title by estoppel.

§ 915. *When it will be raised.* — In some rather exceptional cases, however, the company may be estopped by the issue of a certificate even when the certificate has never passed from the possession or control of the person to whom it was issued. Wherever it can be shown that the person to whom the certificate was issued altered his position in some way to his prejudice in reliance upon the company's representation that he was entitled to the shares represented, or supposed to be represented, by the certificate and that he acted as a reasonable man in so relying thereon, the company will be estopped from denying the truth of its representation just as it would be in the case of a transferee of the certificate. For instance, the company will be estopped if the person to whom the certificate is issued makes a contract to sell the shares supposed to be represented by the certificate and so incurs liability,⁴ or pays a call upon the shares.⁵ So, where the person to whom the certificate is issued is led to believe that everything in connection with his title is correct — is lulled into security — so that he loses his remedy against the person who was responsible for the defect in his title, the com-

¹ *Metropolitan Sav. Bank v. N. E.* 109; 15 Am. St. Rep. 222; *Mayor, etc. of Baltimore*, 63 Md. 6 5 L. R. A. 849.

(holding that the corporation is liable to make good to the lender money advanced to the forger after the issue of a certificate in the forger's name but not money advanced to the forger prior to that time upon the faith of the old certificate with forged transfer endorsed thereon).

² *Simm v. Anglo-American Telegraph Co.*, 5 Q. B. D. 188; *Erskine v. Læwenstein*, 82 Mo. 301, 305-306 (headnote inadequate).

Cf. *Farrington v. South Boston R. R. Co.*, 150 Mass. 406, 408; 23

³ Cf. *Fifth Ave. Bank v. Forty-second St., etc. R. R. Co.*, 137 N. Y. 231, 238; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331.

⁴ *Balkis Consolidated Co. v. Tomkinson* (1893), A. C. 396.

But the rule is otherwise where the contract of sale was made after notice of the forgery. *Hambleton v. Central Ohio R. R. Co.*, 44 Md. 551.

Cf. *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; 20 Am. Rep. 90.

⁵ *Hart v. Frontino Gold Mining Co.*, L. R. 5 Ex. 111.

pany is estopped from denying his right to the shares.¹ For instance, the company will be estopped if the broker who sold the shares to the person to whom the company issued the certificate becomes in the meantime insolvent so that the remedy against him becomes worthless; but in order to raise an estoppel of this sort, it must appear, first, that the broker was originally solvent,² so that the person to whom the company issued the certificate had originally a valuable remedy, and secondly, that the broker subsequently became insolvent,³ so that the remedy became worthless; and thirdly, that the inaction was really in reliance upon the company's representation and was not due to some other cause.⁴ The person who invokes the estoppel must prove affirmatively the insolvency of the broker or other person against whom he claims that a remedy was lost; but solvency at the time of the issue of the certificate will be presumed unless the contrary appear.⁵

If a person claiming under a forged or otherwise invalid transfer agrees to sell the shares and accordingly presents the transfer for registration with a request that a certificate be issued in the name of his vendee without any active intervention on the latter's part, the vendee, if he pay the money on the faith of the new certificate so made out in his name, may hold the company estopped from denying his title.⁶

Where an agent of the corporation issues shares on its behalf to a person who understands that he is acquiring shares not by transfer, but from the company itself, the company is liable if the transaction was within the real or apparent scope of the agent's authority; but not otherwise.⁷

§ 916. *Whether Person to whom Certificate was issued acts reasonably in relying thereon.* — Furthermore, the estoppel will not be raised unless the person to whom the certificate was issued acted reasonably in relying upon the company's assur-

¹ *Dixon v. Kennaway & Co.* (1900), 1 Ch. 833; *Manhattan Beach Co. v. Harned*, 27 Fed. 484.

² *Foster v. Tyne Pontoon, etc. Co.*, 63 L. J. Q. B. 50, 55-56.

³ *Dixon v. Kennaway, etc. Co.* (1900), 1 Ch. 833.

⁴ *Foster v. Tyne Pontoon Co.*, 63 L. J. Q. B. 50, 55.

⁵ *Dixon v. Kennaway & Co.* (1900), 1 Ch. 833.

⁶ *Trimble v. Union Nat. Bank*, 71 Mo. App. 467.

Cf. *Machinists Nat. Bank v. Field*, 126 Mass. 345.

⁷ *Rogers v. Southern Fiber Co.* (La.), 44 So. 442. See also *supra*, § 581. Cf. *supra*, § 800.

ance of the soundness of his title. Whether he does act reasonably in so relying depends in part on whether the defect in his title is due to circumstances of which he has at least as much opportunity of knowing as the company, or to facts which lie peculiarly within the knowledge of the corporation. If the latter be the case, he is entitled to rely upon the company's assurance.¹ For instance, if the defect in his title be due to the fact that the person from whom he derived title was not the registered owner of the shares, he is not guilty of negligence because he relies upon the certificate issued to him by the company and fails to inspect the register so as to discover the defect in his title.²

On the other hand, where the defect in the title grows out of facts which do not lie peculiarly within the knowledge of the company, particularly where the company has been induced to issue the certificate by some representation express or implied of the person to whom it is issued, the latter has no right to go to sleep in reliance upon the certificate, and if he do so cannot hold the company estopped by the certificate. This principle finds application in the case of forged transfers. If a person presents to a corporation a forged transfer of shares and requests registration, he impliedly represents that the transfer is genuine;³ and, however innocent he may have been of complicity in the forgery or even of any knowledge or suspicion that the transfer was spurious, he cannot complain that by registering the transfer and issuing a certificate according to his request the company lulled him into security, and if by reason of his false feeling of security he loses his remedy against the forger or against any other person, he cannot maintain that the company is estopped from denying his title.⁴

¹ *Balkis Consolidated Co. v. Tomkinson* (1893), A. C. 396 (headnote inadequate).

² *Dixon v. Kennaway & Co.* (1900), 1 Ch. 833. See also *Salisbury Mills v. Townsend*, 109 Mass. 115; *Cincinnati, etc. Ry. Co. v. Citizens' Nat. Bank*, 56 Oh. St. 351; 47 N. E. 249; 43 L. R. A. 777.

But cf. *Houston, etc. Ry. Co. v. Van Alstyne*, 56 Tex. 439.

³ *Infra*, § 942.

⁴ *Simm v. Anglo-American Telegraph Co.*, 5 Q. B. D. 188.

Cf. *Balkis Consolidated Co. v. Tomkinson* (1893), A. C. 396; *Boston, etc. R. R. Co. v. Richardson*, 135 Mass. 473; *Trimble v. Union Nat. Bank*, 71 Mo. App. 467; *Hildyard v. South Sea Co.*, 2 P. Wms. 76; *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; 20 Am. Rep. 90; *Hamble-*

§ 917-§ 921. *Requisites of Certificate in order to raise Estoppel.*

§ 917. **Certificate must be issued by Authority of Company.** — In order that the company should be estopped by the issue of a certificate, there must of course be evidence that the certificate was issued by the company's authority — that is to say, by agents of the corporation acting within the scope of their real or apparent authority.¹

Whether the issue of the certificate can be deemed within the scope of authority of the officers or agents by whom the issue is effected must be decided by the principles of the law of agency, which are not within the scope of the present discussion. The fact that the agent in issuing the certificate is acting fraudulently and for his own gain is by no means conclusive to show that the instrument is not issued within the scope of the agent's authority so as to estop the company. The circumstance that a share-certificate, while not technically negotiable, is intended to pass from hand to hand as the evidence of ownership of the shares which it purports to represent is sufficient to exclude the application of the doctrine of *Grant v. Norway*,² in which leading case the court held that a carrier is not bound by a bill of lading issued by an agent where no goods at all had been delivered for carriage. In the case of certificates of shares, issued by a transfer agent to a supposed transferee, the company may, therefore, be bound although no transfer at all had been presented.³ Indeed, even the fact that some at least

ton v. Central Ohio R. R. Co., 44 Md. 551; *Ruben v. Great Fingall Consolidated* (1906), A. C. 439.

As to the rights of the company against a transferee under a forged transfer, see *infra*, § 941.

¹ *Farmers' Bank v. Diebold Safe, etc. Co.*, 66 Oh. St. 367; 64 N. E. 518; 90 Am. St. Rep. 586; 58 L. R. A. 620 (where a certificate which had been endorsed in blank and delivered to the company as collateral security was fraudulently abstracted and reissued by the secretary); *Rogers v. Southern Fiber Co.* (La.), 44 So. 442 (custody of cor-

porate seal and blank certificates of stock not sufficient evidence of authority in president).

² *Grant v. Norway*, 10 C. B. 665.

³ *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30; *Fifth Ave. Bank v. Forty-second St., etc. R. R. Co.*, 137 N. Y. 231; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331; *Havens v. Bank of Tarboro*, 132 N. Car. 214; 43 S. E. 639; 95 Am. St. Rep. 627.

But see *Hall v. Rose Hill, etc. Co.*, 70 Ill. 673. This case would seem difficult to reconcile with the rule in *Royal British Bank v. Turquand*, 6

of the signatures attached to a certificate are forgeries and that the seal of the company is affixed without the authority of the directors will not prevent the certificate from estopping the company if it was issued from the company's office by a transfer agent clothed with apparent authority and impliedly representing the instrument to be valid.¹

On the other hand, where in 1881 a certificate was signed in blank by the president of a company and intrusted to the other officers to be used in case a shareholder should desire to transfer his shares in the president's absence, and where in 1888 the then president of the company, who in 1881 had been secretary, filled up the blanks, inserting his own name as shareholder, and forging the signature of the person who had been treasurer in 1881 (which was the date borne by the certificate), and countersigning with his own name as secretary, the court held that the forger's authority to issue certificates dated in 1881 while he was secretary had absolutely determined upon his ceasing to hold the office of secretary, and consequently that even a *bona fide* purchaser or pledgee from the forger had no claim against the company by reason of the certificate.²

§ 918. **Certificates issued for unlawful Purposes.** — It has been held by high authority that share-certificates issued in aid of rebellion will not create any estoppel prejudicial to the loyal

E. & B. 327 (as to which see *infra*, § 1474), and with established principles of the law of agency.

Cf. *Mechanics Bank v. New York, etc. R. R. Co.*, 13 N. Y. 599.

¹ *Shaw v. Port Philip Mining Co.*, 13 Q. B. D. 103; *Fifth Avenue Bank v. Forty-second St., etc. R. R. Co.*, 137 N. Y. 231; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331; *Hellman v. Forty-second St., etc. R. R. Co.*, 74 Hun 529; 26 N. Y. Supp. 553, affirmed short, 148 N. Y. 727; 42 N. E. 723; *Tome v. Parkersburg Branch R. R. Co.*, 39 Md. 36; 17 Am. Rep. 540.

Cf. *Jarvis v. Manhattan Beach Co.*, 53 Hun (N. Y.) 362; 6 N. Y. Supp. 703, affirmed, 148 N. Y. 652; 43 N. E. 68; 31 L. R. A. 776; 51 Am. St. Rep. 727; *Western Md.*

R. R. Co. v. Franklin Bank, 60 Md. 36.

But see *Hill v. Jewett Publishing Co.*, 154 Mass. 172; 28 N. E. 142; 26 Am. St. Rep. 230; 13 L. R. A. 193; *Ruben v. Great Fingall Consolidated* (1906), A. C. 439 (a mere dictum, since the person in whose favor the estoppel was invoked was the person to whom the certificate was issued and, therefore, under the circumstances was not entitled to rely thereon).

² *Manhattan Life Ins. Co. v. Forty-second St., etc. R. R. Co.*, 139 N. Y. 146; 34 N. E. 776. Note that *Mutual Life Ins. Co. v. Forty-second St., etc. R. R. Co.*, 74 Hun 505; 26 N. Y. Supp. 545, a later case in a lower New York court, would seem to be inconsistent with the principal case.

members of the company.¹ Perhaps this decision was due in part to unconscious political prejudice. At any rate, it would hardly be a safe generalization that certificates issued for any illegal purpose will be insufficient to raise an estoppel against the company.

§ 919. **Certificate issued to one of the Officers who sign it on behalf of the Company.** — The fact that one of the officers who sign a share-certificate is the person named therein as the owner of the shares represented thereby is not deemed a suspicious circumstance, and will not prevent the raising of an estoppel in favor of a *bona fide* purchaser who relies upon the certificate.² The certificate is held to be sufficiently authenticated by the signature of the other and disinterested officer, and by the corporate seal. There is nothing to excite suspicion in such a certificate as there is, according to many authorities, in a note payable to one of the officers who execute it on behalf of the company; for although officers should not ordinarily enter into contracts with the corporation, yet officers are usually shareholders and must have certificates as evidence of title.

§ 920. **Certificate surrendered to Company and reissued without its Authority.** — Where a share-certificate which has been surrendered to the corporation for cancellation is abstracted from the company's safe and sold to a *bona fide* purchaser by an employee who had access thereto, the company is not deemed chargeable with negligence even though the failure to cancel the certificates upon their surrender was a violation of the by-laws: and hence the company is not estopped from denying the title of the purchaser of the certificates to the shares purporting to be represented thereby.³

¹ *Dewing v. Perdicaries*, 96 U. S. 193. *ton R. R. Co.*, 150 Mass. 406; 23 N. E. 109; 15 Am. St. Rep. 222; 5 L. R. A. 849.

Cf. *Central R. R. & Banking Co. v. Ward*, 37 Ga. 515.

² *Titus v. Great Western Turnpike Road*, 61 N. Y. 237; *Cincinnati, etc. Ry. Co. v. Citizens' Nat. Bank*, 56 Oh. St. 351; 47 N. E. 249; 43 L. R. A. 777 (overruling *Cincinnati, etc. Ry. Co. v. Third Nat. Bank*, 1 Oh. Circ. Ct. 199); *Western Md. R. R. Co. v. Franklin Bank*, 60 Md. 36, 47-48.

But see *Farrington v. South Bos-*

Cf. *Havens v. Bank of Tarboro*, 132 N. Car. 214; 43 S. E. 639; 95 Am. St. Rep. 627; *Lucile Dreyfus Mining Co. v. Willard* (Wash.), 89 Pac. 935, 938-940 (headnote inadequate).

³ *Knox v. Eden Musee Co.*, 148 N. Y. 441; 42 N. E. 988; 51 Am. St. Rep. 700; 31 L. R. A. 779.

Cf. *supra*, p. 739, n. 1.

§ 921. **Informal Certificates.** — A share-certificate may estop the company, though not under the corporate seal, to the same effect as if the seal were duly affixed.¹ The seal, though usual, is not necessary in order to make the instrument a share-certificate.² Indeed, although the certificate expressly state that it shall not be deemed evidence of the holder's title, the estoppel may nevertheless be raised.³ However, the more informal the instrument be, and the less it resemble the ordinary and normal share-certificate, the more difficult it will be to raise an estoppel.⁴

§ 922-§ 923. *Estoppel raised otherwise than by Issue of Share-Certificate.*

§ 922. **In general.** — Whilst it would be too sweeping an assertion to say that a corporation can be estopped from denying the title of a claimant to shares in no other way than by the issue of a share-certificate, yet that is far the most usual ground of estoppel. Other forms of representation sufficient to raise an estoppel, there may undoubtedly be; but they are rarely met with. Unless the company has issued a share-certificate, there is apt to be very great difficulty in making out a case of estoppel.⁵ For instance, the regular payment of dividends to a claimant of shares may have the effect of lulling him into security and of leading him to believe his title to be unimpeachable, yet it does not amount to a representation made by the company with a view to being acted upon that his title is good, and consequently is no foundation for an estoppel.⁶ Likewise, entering a person's name in the register of shareholders does not, it is submitted, amount to a representation upon which he is entitled to rely that his title needs no attention.⁷ If, however, a

¹ *Hart v. Frontino Gold Mining Co.*, L. R. 5 Ex. 111 (headnote inadequate). *Delaware Loan Co.*, 9 Houst. (Del.) 354; 32 Atl. 980, although not called a share-certificate would seem to have been such in legal effect.

² Cf. *supra*, § 512.

³ *Hart v. Frontino Gold Mining Co.*, L. R. 5 Ex. 111 (headnote inadequate). ⁶ *Foster v. Tyne Pontoon, etc. Co.*, 63 L. J. Q. B. 50, 54. Cf. *Hambleton v. Central Ohio R. R. Co.*, 44 Md. 551.

⁴ See *infra*, § 923, as to "certification."

⁵ The instrument relied upon to raise an estoppel in *Richardson v.* ⁷ *Foster v. Tyne Pontoon, etc. Co.*, 63 L. J. Q. B. 50, 55. But see *Hart v. Frontino Gold*

person who is contemplating dealing in certain shares inquires of the company whether a certain share-certificate (which in fact is forged) is valid and whether a transfer endorsed thereon is genuine, an affirmative answer will estop the company from asserting as against him that the certificate is spurious and the supposed transferor and endorser a fictitious person.¹

§ 923. **No Estoppel from Certification of Transfer.**—The “certification” of a transfer according to the English custom cannot, at least as a general rule, be relied upon as foundation for an estoppel.² A certification, as explained above, is an informal written statement given out by the company to the effect that a share-certificate has been lodged with the company by a certain person. But by reason of its informality and also because of the fact that it is not intended to pass from hand to hand or to be used like a share-certificate as evidence of the holder’s title, the House of Lords has held that, like a bill of lading, it is within the doctrine of *Grant v. Norway*, so that if the company’s secretary “certificates” a transfer when in fact no share-certificate has been lodged with the company, his act is deemed to be without the scope of his authority and will not estop the company from showing that fact.³ This decision of the House of Lords is sometimes cited in the United States as though it were applicable to ordinary share-certificates. This is a fundamental error, and overlooks the whole point of the case. The very ground of the decision was that the informal “certification” could not, like a formal share-certificate, be relied upon to raise an estoppel. Lord James of Hereford added an express caution: “The judgment now given must not be

Mining Co., L. R. 5 Ex. 111 (head-note inadequate); *Ashby v. Blackwell*, 2 Eden 299, Ambler 503; *Central R. R. & Banking Co. v. Ward*, 37 Ga. 515; *Bank of England v. Cutler* (1907), 1 K. B. 889 (where the Bank of England by permitting registration of a forged transfer of India Stock was held to be estopped from denying the title of the transferee to the prejudice of a subsequent bona fide purchaser from him).

53 Hun (N. Y.) 362; 6 N. Y. Supp. 703; affirmed, 148 N. Y. 652; 43 N. E. 68; 31 L. R. A. 776; 51 Am. St. Rep. 727.

Cf. *Fifth Ave. Bank v. Forty-second St., etc. R. R. Co.*, 137 N. Y. 231; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331; *Mutual Life Ins. Co. v. Forty-second St., etc. R. R. Co.*, 74 Hun (N. Y.) 505, 514-517; 26 N. Y. Supp. 545.

² *Supra*, § 869.

³ *George Whitechurch, Ltd. v.*

¹ *Jarvis v. Manhattan Beach Co.*, *Cavanagh* (1902), A. C. 117.

supposed to extend to certificates which are made evidence of title by the Act of 1862, and which are passed under the seal of the company.”¹

§ 924—§ 944. *RIGHTS AND LIABILITIES UPON PRESENTATION OF TRANSFER FOR REGISTRATION.*

§ 924—§ 939. *LIABILITIES OF COMPANY.*

§ 924—§ 930. *Duties and Rights of Company upon presentation of Transfer for Registration.*

§ 924: *Duty in general to register any valid Transfer when presented.* — When a valid transfer is duly presented for registration, the duty of the company is to register it and enter the transferee's name in the list of shareholders.² Unless expressly conferred by statute or the company's regulations, neither the directors nor the shareholders in a corporation have any discretion to decline to register a valid transfer.³ It makes no difference that the transfer may be very prejudicial to the interests of the company.⁴ For instance, the company cannot decline to register a transfer because the transferor is indebted for calls or otherwise, unless such a power is expressly conferred by the regulations;⁵ nor because the transferee is engaged in a rival

¹ *George Whitechurch, Ltd. v. Mullanphy Sav. Bank*, 8 Mo. App. 249; *People ex rel. Bosqui v. Crockett*, 9 Cal. 112; *Herdegen v. Cotzhausen*, 70 Wisc. 589; 36 N. W. 385;

² As to the right to refuse to register a transfer which is insufficiently stamped, see *Maynard v. Consolidated Kent Collieries Corp.* (1903), 2 K. B. 121.

³ *Weston's Case*, 4 Ch. 20; *Gilbert's Case*, 5 Ch. 559, 565 (semble); *Imperial Starch Co.*, 10 Ont. L. R. 22 (holding that express authority to regulate transfers does not justify a prohibition of transfers); *Smith v. Bank of Nova Scotia*, 8 Can. Sup. Ct. 558.

⁴ *Townsend v. McIver*, 2 S. Car. 25.

⁵ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 99–100; 19 Am. Dec. 306; *Heart v. State Bank*, 2 Dev. Eq. (N. Car.) 111; *Carroll v.*

Herrick v. Humphrey Hardware Co. (Nebr.), 103 N. W. 685. Cf. *infra*, § 955.

But see *Ex parte Parker*, 2 Ch. 685 (where the court refused to order registration of a transfer made to escape payment of certain calls the making of which the transferor had persuaded the directors to postpone for the very purpose of getting an opportunity to effect the transfer).

A shareholder may, by agreement — for example, by accepting a share-certificate which states that no transfer by a shareholder indebted to the company will be permitted — voluntarily give the com-

business.¹ In England, the transfer must be registered, although it be made to a man of straw for the very purpose of escaping liability as a shareholder,² provided only it be not colorable merely — that is, provided the transferor retain no interest in the shares. In America, the company may always decline to register a transfer made to a man of straw in contemplation of insolvency on the part of the company for the purpose of escaping liability;³ but even with us a company cannot lawfully refuse to register a transfer merely because the transferee is insolvent.⁴ Indeed, the fact that the transferee is an undischarged bankrupt is no excuse for refusing to register the transfer.⁵ The motive or purpose of a transfer is generally quite immaterial so far as the duty of the company to register the transfer is concerned.⁶ If, however, a transfer is executed to a corporation which has no corporate capacity to hold shares in another company, registration of the transfer may be refused.⁷

§ 925. **Right to regulate Times at which Transfers may be registered.** — The company may, of course, refuse to receive transfers for registration at unreasonable hours. For instance, they are not bound to receive and register a transfer presented at midnight. So, too, as to the days on which transfers can be registered. They are not bound to register a transfer on Sunday, or on a holiday, or on Saturday or Wednesday, or any other day that they may deem inconvenient, so long as the right to

pany a contractual right to refuse to register a transfer. *Reynolds v. Bank of Mt. Vernon*, 6 N. Y. App. Div. 62; 39 N. Y. Supp. 623, affirmed short, 158 N. Y. 740; 53 N. E. 1131. See also *supra*, § 707, § 708.

¹ *Rice v. Rockefeller*, 134 N. Y. 174; 31 N. E. 907; 30 Am. St. Rep. 658; 17 L. R. A. 237.

² *Regina ex rel. Crea v. Midland Counties Ry.*, 15 Ir. Com. L. 525; *Weston's Case*, 4 Ch. 20; *Cawley & Co.*, 42 Ch. D. 209.

³ That such a transfer, even if registered, does not release the transferor from liability as a shareholder, see *supra*, § 765.

⁴ *Chouteau Spring Co. v. Harris*, 20 Mo. 382.

⁵ *Sutton v. English & Colonial Produce Co.* (1902), 2 Ch. 502.

⁶ *Re Klaus*, 67 Wisc. 401; 29 N. W. 582; *State ex rel. Page v. Smith*, 48 Vt. 266; *Rice v. Rockefeller*, 134 N. Y. 174; 31 N. E. 907; 30 Am. St. Rep. 658; 17 L. R. A. 237; *Townsend v. McIver*, 2 S. Car. 25; *Senn v. Union, etc. Mercantile Co.*, 115 Mo. App. 685; 92 S. W. 507.

Cf. *infra*, § 1217, as to transfers for the purpose of increasing transferor's voting rights. See also *Baker's Appeal*, 108 Pa. St. 510; 1 Atl. 78; 56 Am. Rep. 231.

As to the power of a court of equity to refuse to aid a transfer made for the purpose of wrecking the company, see *infra*, § 934.

⁷ See *supra*, § 878.

transfer is not, under color of such rules, substantially abridged. Moreover, companies may, and often do, close their transfer books temporarily for some reasonable time prior to a shareholder's meeting,¹ or to the declaration of a dividend.² If this were not done, it might be difficult to determine who should have the right to vote at the meeting or to receive the dividend.

§ 926. **Right to refuse to register Transfers after Insolvency of Company.** — Furthermore, when the company is insolvent and after the directors have resolved, subject to the approval of a shareholders' meeting, to go into liquidation, they may direct that no transfers subsequently received shall be registered.³ Such a step is regarded as a reasonable preliminary to the winding-up, and is proper in order to preserve the *status in quo* for the benefit of creditors and to prevent all solvent shareholders from assigning their shares and escaping liability. This rule, which prevails in England as well as in the United States, is in some ways a close approximation to the American doctrine which, as stated above, precludes a shareholder from transferring his shares to a man of straw in contemplation of the company's insolvency for the purpose of escaping liability.⁴ However, the company cannot refuse to register a transfer which was made and presented for registration before the company's insolvency, although after presentation of the transfer the company has become insolvent.⁵ Moreover, where a bank which has suspended payment resolves not to go into liquidation but to attempt to rehabilitate itself, it cannot refuse to register transfers subsequently made by its shareholders.⁶

§ 927. **Right to delay for Consideration of Validity of Transfer.** — Moreover, a company is never bound to register a transfer

¹ *Cook v. Carpenter* (Pa.), 61 Atl. 804; 212 Pa. 177.

Contra: *Panton and the Cramp Steel Co.*, 9 Ont. L. R. 3.

² *Jones v. Terre Haute, etc. R. R. Co.*, 57 N. Y. 196, 202 (semble — where the company adopted the unusual and, as the court held, unreasonable course of opening the books again for a day or two immediately before the declaration of the dividend).

³ *A. Mitchell's Case*, 4 A. C. 548; *N. Mitchell v. City of Glasgow Bank*, 4 A. C. 624.

Cf. *Richmond v. Irons*, 121 U. S. 27, 56-59; 7 Sup. Ct. 788; *Violet Consolidated Gold Mining Co.*, 80 L. T., N. S., 684.

⁴ *Supra*, § 765.

⁵ *Nation's Case*, 3 Eq. 77.

⁶ *Smith v. Bank of Nova Scotia*, 8 Can. Sup. Ct. 558.

forthwith upon its presentation:¹ a reasonable delay for the purpose of investigating the genuineness of the transfer is always justifiable.² Indeed, in England, the common practice seems to be, upon presentation of a transfer, to post a letter of inquiry to the address of the person named as transferor;³ and not until the expiration of a reasonable time for reply to this letter or until an answer recognizing the transfer as genuine is actually received, will the company proceed with registration. In the United States such care and deliberation are not usually practised, but are nevertheless always permissible and proper. A peremptory refusal to register, however, not placed upon the ground of a desire to investigate the transfer, is not justifiable because the company might properly have demanded time for investigation.⁴ Moreover, temporizing on the part of the company will not be tolerated; and evasive, dilatory answers to a request to register a transfer will be equivalent to an absolute refusal.⁵

§ 928. **Right to demand Evidence of Validity — Production of Transferor's Certificate, etc.** — The company may also require the person who presents a transfer for registration to adduce reasonable evidence of its genuineness. Precisely what evidence shall be required rests within the discretion of the officers of the company. To insist upon the production of the transferor's share-certificate is certainly a reasonable requirement;⁶ and indeed in most cases, at least in America, a surrender of the certificate would be necessary in order to relieve the company

¹ Cf. *Tucker v. Mulligan*, 28 Vict. L. R. 1 (holding that under the company's articles of association fourteen days were to be allowed for registering a transfer).

² *Société Générale de Paris v. Walker*, 11 A. C. 20, 41; *Ireland v. Hart* (1902), 1 Ch. 522, 528-529 (headnote inadequate).

³ See *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77; *Johnston v. Renton*, 9 Eq. 181.

⁴ *Ottos Kopje Diamond Mines* (1893), 1 Ch. 618.

Cf. *Ex parte Sargent*, 17 Eq. 273.

⁵ *Goodwin v. Ottawa, etc. Ry. Co.*, 13 Up. Can. C. P. 254.

⁶ *Colonial Bank v. Whinney*, 11 A. C. 426; *Société Générale de Paris v. Walker*, 11 A. C. 20; *State ex rel. Martin v. New Orleans, etc. R. R. Co.*, 30 La. Ann. 308; *Supply Ditch Co. v. Elliott*, 10 Colo. 327; 15 Pac. 691; 3 Am. St. Rep. 586; *Isbell v. Graybill*, 19 Colo. App. 508; 76 Pac. 550.

Cf. *Shropshire Union Rys., etc. Co. v. Queen*, L. R. 7 H. L. 496; *National Bank v. Lake Shore, etc. Ry. Co.*, 21 Oh. St. 221 (where plaintiff claimed under an attachment against an equitable owner of shares).

from liability in case the certificate should subsequently turn up in the hands of somebody else.¹ If the certificate is proved to be lost or destroyed the company may be required to register the transfer if a sufficient bond of indemnity be given;² but the directors are not guilty of a wrong in refusing to accept a bond which they honestly deem insufficient.³ The company may require the transferor's certificate to be not merely exhibited for a hasty inspection, but may also require it to be deposited and left at the transfer office for examination at leisure, before a transfer will be registered;⁴ but the failure to deposit the certificate cannot be relied upon to excuse the refusal to register the transfer if the refusal was placed exclusively on another ground.⁵ That the transfer fails to state the address of the transferor or to specify the denoting numbers of the shares is no ground for refusing registration, even where the regulations of the company require all transfers to be "in the usual common form."⁶

§ 929. *Where Transferor is Trustee or other Fiduciary.* — If the shares are held in trust, reasonable evidence of the authority of the trustee to transfer them may properly be required.⁷

§ 930. **Right to demand Evidence of Acceptance by Transferee.** — A corporation before registering a transfer of shares may properly demand satisfactory evidence of acceptance on the part of the transferee, and cannot be compelled to register a transfer to a person who refuses to accept the same even though that refusal be a breach of a contract between him and the transferor.⁸ The necessity for acceptance on the transferee's part

¹ See supra, § 910.

See also *Smith v. Am. Coal Co.*, 7 Lans. (N. Y.) 317.

² *Colonial Bank v. Whinney*, 11 A. C. 426, 437-438 (semble, per Lord Blackburn); *Kinnan v. Forty-second St., etc. Ry. Co.*, 140 N. Y. 183; 35 N. E. 498. Cf. supra, § 516.

³ *Société Générale de Paris v. Walker*, 11 A. C. 20.

⁴ *East Wheel Mining Co.*, 33 Beav. 119.

⁵ *Bond v. Mount Hope Iron Co.*, 99 Mass. 505; 97 Am. Dec. 49.

⁶ *Letheby & Christopher* (1904), 1 Ch. 815 (headnote inadequate).

⁷ *Bayard v. Farmers', etc. Bank*, 52 Pa. St. 232.

Cf. *First Nat. Bank v. National Broadway Bank*, 156 N. Y. 459; 51 N. E. 398; 42 L. R. A. 139; *Spelissy v. Cook & Bernheimer Co.*, 58 N. Y. App. Div. 283; 68 N. Y. Supp. 995.

As to what is sufficient evidence of an executor's authority to transfer shares, see infra, § 981.

⁸ *Russell v. Easterbrook*, 71 Conn. 50; 40 Atl. 905.

and the effect of a transfer registered without such acceptance have been discussed above.¹

§ 931. **To whom Transfer should be presented for Registration.** — The demand that a transfer be registered should ordinarily be made upon the officer or agent in charge of the transfer books. A demand on the person in charge of the company's principal office is *prima facie* sufficient.² A demand outside the office may have the same effect as if made within its four walls.³

§ 932-§ 934. *Remedies against Company for wrongfully refusing to register Transfer.*

§ 932. **Remedies of Transferor.** — If a corporation wrongfully refuses to register a transfer, the transferor has several remedies. First, he may perhaps sue out a writ of mandamus to compel the company to perform its duty by registering the transfer.⁴ Or, secondly, he may have the same relief upon bill in equity.⁵ Or, thirdly, he may treat the company's action as a conversion of his shares, and sue for damages.⁶ If he pursue the latter course, he is entitled to recover the value of the shares at the time when the company wrongfully refused to register the transfer.⁷ If instead of claiming full damages the transferor

¹ See *supra*, § 872-§ 879.

² *Commercial Bank v. Kortright*, 22 Wend. (N. Y.) 348, 350-351; 34 Am. Dec. 317.

But cf. *Bridgeport Bank v. New York, etc. R. R. Co.*, 30 Conn. 231, 272 (semble).

³ *Dooley v. Gladiator, etc. Co.* (Iowa), 109 N. W. 864.

⁴ *Townsend v. McIver*, 2 S. Car. 25. But see *Rex v. Bank of England*, 2 Doug. 525; *Terrell v. Georgia R. R., etc. Co.*, 115 Ga. 104; 41 S. E. 262; 2 Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., 848-858.

⁵ This relief may be barred by laches. See *Gresham v. Island City Savings Bank*, 2 Tex. Civ. App. 52; 21 S. W. 556.

⁶ *Craig v. Hesperia, etc. Co.*, 113

Cal. 7; 45 Pac. 10; 54 Am. St. Rep. 316; 35 L. R. A. 306; *Withers v. Lafayette County Bank*, 67 Mo. App. 115; *Humphreys v. Minnesota Clay Co.*, 94 Minn. 469; 103 N. W. 338.

But see *Penfold v. Charlevoix Sav. Bank*, 103 N. W. 572 (headnote inadequate); 140 Mich. 126.

As to whether an action *ex contractu* could be maintained, see *Case v. Bank*, 100 U. S. 446 (headnote inadequate).

⁷ *Ottos Kopje Diamond Mines* (1893), 1 Ch. 618.

But see *Penfold v. Charlevoix Sav. Bank*, 103 N. W. 572; 140 Mich. 126.

elect to retain the shares, he cannot subsequently recover more than his actual damages, as in any other case of conversion of a chattel where the plaintiff has retaken possession before the case is tried. In one case, it was held that the transferor who has lost a good sale by the company's refusal to register the transfer, and who afterwards in consequence of a decline in the price of the shares realized much less for them, cannot charge the company with the difference, but that his damages must be nominal merely.¹ The decision was placed upon the ground that the company had no notice of the special terms of the first contract of sale, and therefore under the rule in *Hadley v. Baxendale* could not be charged with special damages arising from the frustration of that contract. Without venturing to question the actual decision, one may be permitted to doubt whether the court in assigning its reason for its conclusion did not overlook the fact that the transferor's cause of action sounded in tort for a conversion.

§ 933. *Remedies of Person selling Shares under a Power.* — It has been held that a pledgee of shares with a power of sale in case of default may sue the company for damages if the latter refuses to register a transfer in pursuance of a sale made under the power.² But in connection with this decision the fact should be borne in mind that a pledgee of shares is not an actual shareholder and that apart from authority serious question might be raised whether he could maintain an action at law in his own name against the company for refusing to recognize his power of sale.

§ 934. *Remedies of Transferee.* — Upon principle, where registration of a transfer is wrongfully refused,³ the transferee has substantially the same remedies as the transferor against the company, notwithstanding the fact that the very question at issue is his right to be deemed a member. Thus, the transferee may compel the company by mandamus⁴ or bill in

¹ *Skinner v. City of London Marine Ins. Corp.*, 14 Q. B. D. 882.

² *Case v. Bank*, 100 U. S. 446.

³ As to whether the transfer need actually be presented for registration before the aid of the courts is invoked, see *Richardson v. Longmont Ditch Co.*, 19 Colo. App. 483; 76 Pac. 546.

⁴ *Green Mount, etc. Co. v. Bulla*, 45 Ind. 1; *Hair v. Burnell*, 106 Fed. 280 (where the writ was against the officers of the company); *Cooper v. Dismal Swamp Canal Co.*, 6 N. Car. 195; *Townsend v. McIver*, 2 S. Car. 25; *Smith v. Automatic Photographic Co.*, 118 Ill. App. 649; *State ex rel. Jurgens v. Consumers'*

equity¹ to register the transfer. That the transfer was without consideration does not diminish the transferee's rights,² nor is the

Brewing Co., 40 So. 45; 115 La. 782.

But see contra: *Shipley v. Mechanics Bank*, 10 Johns. (N. Y.) 484; *Kimball v. Union Water Co.*, 44 Cal. 173; 13 Am. Rep. 157; *Ex parte Firemen's Ins. Co.*, 6 Hill (N. Y.) 243; *Tobey v. Hakes*, 54 Conn. 274; 7 Atl. 551; 1 Am. St. Rep. 114 (where the proceeding was against the company's secretary); *State ex rel. Bornefield v. Rombauer*, 46 Mo. 155 (proceeding against the company's president); *Wilkinson v. Providence Bank*, 3 R. I. 22; *Birmingham Fire Ins. Co. v. Commonwealth*, 92 Pa. St. 72; *Durham v. Monumental Silver Mining Co.*, 9 Oreg. 41; *Stackpole v. Seymour*, 127 Mass. 104 (proceeding against company's president and treasurer); *Murray v. Stevens*, 110 Mass. 95 (against president and secretary); *Freon v. Carriage Co.*, 42 Oh. St. 30; 51 Am. Rep. 794 (where the shares were not salable on the market); *Galbraith v. People's Bldg. & Loan Ass'n*, 43 N. J. Law 389.

Cf. *Regina v. Liverpool, etc. Ry. Co.*, 21 L. J. Q. B. 284 (where the writ was refused because it was thought that the applicant was not proceeding *bona fide*); *Butterfly Terrible Gold Mining Co. v. Brind* (Colo.), 91 Pac. 1101 (writ refused because petition did not allege that any by-laws there might be as to transfers had been complied with); *Crawford v. Provincial Ins. Co.*, 8 Up. Can. C. P. 263 (mandamus refused on the ground that registration was under the statutes applicable to this company unnecessary to perfect transferee's title); 2 Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., 848-858 (containing an elaborate discussion of the question).

The mandamus may run against the corporation without making its

officers parties defendant. *Goodwin v. Ottawa, etc. Ry. Co.*, 13 Up. Can. C. P. 254.

¹ *Rice v. Rockefeller*, 134 N. Y. 174; 31 N. E. 907; 30 Am. St. Rep. 658; 17 L. R. A. 237; *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365; 32 Am. Rep. 315; *Fleckheimer v. Nat. Exchange Bank*, 79 Va. 80; *Real Estate Trust Co. v. Bird*, 90 Md. 229; 44 Atl. 1048; *Buckmaster v. Consumers' Ice Co.*, 5 Daly (N. Y.) 313; *Hubbard v. Bank of U. S.*, 12 Fed. Cas. 777; *Spencer v. James*, 10 Tex. Civ. App. 327; 31 S. W. 540; 43 S. W. 556; *Mechanics Bank v. Seton*, 1 Pet. 299; *Scherck v. Montgomery*, 33 So. 507; 81 Miss. 426; *Westminster Nat. Bank v. New England Electric Works*, 62 Atl. 971; 73 N. H. 465; 111 Am. St. Rep. 637; *Gould v. Head*, 41 Fed. 240, 248 (bill maintained against the company's officers without joining the company itself as defendant).

Cf. *Gresham v. Island City Sav. Bank*, 2 Tex. Civ. App. 52; 21 S. W. 556 (where the plaintiff was held to be barred by the laches of the transferor); *Archer v. American Water Works Co.*, 50 N. J. Eq. 33; 24 Atl. 508.

But see *Cooper v. Dismal Swamp Canal Co.*, 6 N. Car. 195.

Quære, whether the transferor is a necessary party to the bill. Cf. *Buffalo German Ins. Co. v. Third Nat. Bank*, 19 N. Y. Misc. 564; 43 N. Y. Supp. 550; *Mechanics Bank v. Seton*, 1 Pet. 299, 306; *Baltimore Retort, etc. Co. v. Mali*, 65 Md. 93; 3 Atl. 286; 57 Am. St. Rep. 304; *Wadlinger v. First Nat. Bank*, 209 Pa. 197; 58 Atl. 359; *Thornton v. Martin*, 116 Ga. 115; 42 S. E. 348.

² *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365; 32 Am. Rep. 315; *Gilkinson v. Third Ave. R. R. Co.*, 47 N. Y. App. Div. 472; 63 N.

illegality of the consideration any defence to the company.¹ But if the transferee's object is to acquire control of the company for the purpose of wrecking it, a court of equity may refuse to lend him its aid.² It is no answer to a bill in equity to compel execution of a transfer that the company has previously registered another transfer of the same shares without requiring a surrender of the certificate, if the company and the transferee in the last-mentioned transfer were all the time apprised of plaintiff's rights.³ If the transferee neglects for a long period of time to present the transfer for registration, he may be held to be estopped, or barred by laches, from obtaining relief;⁴ but there is also authority, supported by weighty reasons, for the view that no mere delay in presenting the transfer should operate as a bar.⁵ If the transferor has executed an agreement, of which the transferee had notice, to assent to a plan for the winding-up of the company or its consolidation with another corporation, a court of equity in directing the transfer to be registered may qualify its decree with a proviso that the transferee should be bound by the agreement to the same extent as the transferor.⁶

It would seem also that the transferee should have the right to maintain an action for damages on the theory that the legal title to the shares vested in him as soon as an immediate right to be registered as shareholder accrued, and that the company by refusing to recognize his legal title converted the shares, and should be liable to him as in trover.⁷ The transferee has also

Y. Supp. 792; *Senn v. Union etc., Mercantile Co.*, 115 Mo. App. 685, 696 (headnote inadequate); 92 S. W. 507. See supra, § 884.

¹ *Crenshaw v. Columbian Mining Co.*, 110 Mo. App. 355; 86 S. W. 260.

² *Gould v. Head*, 41 Fed. 240; *Senn v. Union, etc. Mercantile Co.*, 115 Mo. App. 685; 92 S. W. 507 (semble).

³ *Cushman v. Thayer Mfg. Jewelry Co.*, 76 N. Y. 365, 370; 32 Am. Rep. 315.

⁴ *Newberry v. Detroit, etc. Iron Co.*, 17 Mich. 141.

Cf. *Pueblo Sav. Bank v. Richardson* (Colo.), 89 Pac. 799 (where a statute required the transfer to be presented within sixty days).

⁵ *Barker v. Montana Gold, etc. Co.* (Mont.), 89 Pac. 66.

⁶ *Senn v. Union, etc. Mercantile Co.*, 115 Mo. App. 685; 92 S. W. 507.

⁷ *Ottos Kopje Diamond Mines* (1893), 1 Ch. 618; *Trust & Savings Co. v. Home Lumber Co.*, 118 Mo. 447; 24 S. W. 129 (where the measure of damages was considered); *Hussey v. Manufacturers', etc. Bank*, 10 Pick. (Mass.) 415; *Waln's Assignees v. Bank of North America*, 8 S. & R. (Pa.) 73; 11 Am. Dec. 575; *Nicollet Nat. Bank v. City Bank*, 38 Minn. 85; 35 N. W. 577; 8 Am. St. Rep. 643; *Helm v. Swiggett*, 12 Ind. 194; *German Union, etc. Ass'n v. Sendmeyer*, 50 Pa. St. 67 (bearing also on the measure of damages);

been allowed to recover in assumpsit.¹ The action may be maintained where the secretary of the company refuses to register the transfer, although the transferee is the head officer of the company and might perhaps have registered the transfer himself.² The fact that the transfer was executed in pursuance of an illegal gambling contract is no defence to the company when the objection has not been raised by the transferor.³ The statute of limitations does not begin to run until the transferee is notified that his title is disputed by the company.⁴ The transferee may in the same action recover any dividends that have accrued since he became entitled and which have been wrongfully withheld from him;⁵ or, the transferee whose title the company has wrongfully refused to recognize may in a separate action recover any such dividends from the company without first compelling the company, by bill in equity, to enter the transfer on its books.⁶

Mount Holly, etc. Co. v. Ferree, 17 N. J. Eq. 117 (semble); *McLean v. Medicine Co.*, 96 Mich. 479; 56 N. W. 68 (an action on the case in which it was held that only nominal damages were recoverable); *McMurrich v. Bond Head Harbour Co.*, 9 Up. Can. Q. B. 333; *Ralston v. Bank of California*, 112 Cal. 208; 44 Pac. 476; *Rio Grande Cattle Co. v. Burns*, 82 Tex. 50; 17 S. W. 1043; *Protection Life Ins. Co. v. Osgood*, 93 Ill. 69; *Second Nat. Bank v. First Nat. Bank*, 8 N. Dak. 50; 76 N. W. 504 (as to measure of damages where transferee holds as collateral security merely); *Baltimore City Pass. Ry. Co. v. Sewell*, 35 Md. 239; 6 Am. Rep. 402; *Herrick v. Humphrey Hardware Co.* (Nebr.), 103 N. W. 685; *Dooley v. Gladiator, etc. Co.* (Iowa), 109 N. W. 864 (value at time of refusal recoverable notwithstanding subsequent offer to recognize plaintiff's rights).

¹ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90; 19 Am. Dec. 306; *Commercial Bank v. Kortright*, 22 Wend. (N. Y.) 348; 34 Am. Dec. 317.

Cf. *Rio Grande Cattle Co. v. Burns*, 82 Tex. 50, 57; 17 S. W. 1043.

² *McMurrich v. Bond Head Harbour Co.*, 9 Up. Can. Q. B. 333.

³ *Miller v. Houston City, etc. Ry. Co.*, 55 Fed. 366; 5 C. C. A. 134.

⁴ *Cleveland, etc. R. R. Co. v. Robbins*, 35 Oh. St. 483.

⁵ *Baltimore City Pass. Ry. Co. v. Sewell*, 35 Md. 239; 6 Am. Rep. 402. The soundness of this decision on this point may perhaps be doubted because any dividends that accrued prior to a demand by the transferee were, so far as the company was concerned, payable to the transferor. See *Cleveland, etc. R. R. Co. v. Robbins*, 35 Oh. St. 483; *Brisbane v. Delaware, etc. R. R. Co.*, 94 N. Y. 204; in which cases the company was held not liable to the transferee and holder of the certificate for paying dividends to the transferor and persons to whom by a subsequent transfer the transferor assigned the shares. Cf. *infra*, § 1369.

⁶ *Hill v. Atoka Coal, etc. Co.*, 21 S. W. Rep. 508 (Mo.); *Robinson v. Nat. Bank of New Beirne*, 95 N. Y. 637.

by the company to transfer the shares in violation of his trust to a purchaser or pledgee for value, the corporation is liable to the *cestui que trust*.¹ The liability of the company in damages for registering a transfer cannot be determined upon a bill of interpleader filed by the corporation for the purpose of ascertaining to which of two claimants dividends on the shares should be paid.² The wrongful registration of a transfer being a tort in the nature of a conversion of the true owner's interest, it follows that all persons who aid or incite the wrong are liable as well as the company itself.³

§ 938. **Liability of Company for failing to require Surrender of Transferor's Certificate.** — If the company registers a transfer without exacting a surrender of the share-certificate, so that the legal title to the shares is vested in the transferee, a *cestui que trust* whose equitable interest in the shares has thus been cut off by purchase for value may have an action against the company for damages.⁴ Indeed, the broad principle is accepted in America if not in England that if a company registers a transfer without insisting upon a surrender of the share-certificate, it will be liable to any *bona fide* holder of the certificate.⁵

§ 939. **Estoppel of Owner to proceed against Company for registering invalid Transfer.** — Any circumstances which would estop the true owner of shares from disputing the title of a *bona fide* purchaser claiming under an invalid transfer will also estop such owner from holding the company liable for registering the transfer in good faith in the ordinary course of business. This estoppel would prevent an action for damages against the company. It would also prevent a bill in equity to require the issue of

Telegraph Co. v. Davenport, 97 U. S. 369; *Mayor, etc. of Baltimore v. Norman*, 4 Md. 352 (demand and refusal to restore plaintiff's name to register not condition precedent to action for conversion); *Mayor, etc. of Baltimore v. Ketchum*, 57 Md. 23 (holding that action may be maintained without showing that claimant under invalid transfer is a *bona fide* purchaser).

But see *Telford, etc. Co. v. Gerhab* (Pa.), 13 Atl. 90.

¹ *Lowry v. Commercial, etc. Bank*, Taney 310. See infra, § 989, et seq.

As to liability for registering wrongful transfers by executors, see infra, § 981.

² *Salisbury Mills v. Townsend*, 109 Mass. 115.

³ *Greenleaf v. Ludington*, 15 Wisc. 558; 82 Am. Dec. 698.

⁴ *N. Y., etc. R. R. Co. v. Schuyler*, 34 N. Y. 30, 81-86 (headnote inadequate). Cf. infra, § 989.

Cf. *Brisbane v. Delaware, etc. R. R. Co.*, 94 N. Y. 204; *Smith v. Am. Coal Co.*, 7 Lans. (N. Y.) 317.

⁵ See supra, § 910.

new share-certificates to the owner if certificates have been previously issued honestly to a person claiming under the invalid transfer and have come, or may have come, into the possession of a holder for value whose title the company would be estopped from denying.¹

§ 940-§ 941. *Liability of Claimant under invalid Transfer which is wrongfully registered.*

§ 940. **Liability to true Owner of the Shares.** — Besides his various remedies against the company, the owner of shares whose name is stricken from the register of shareholders in pursuance of a forged or otherwise invalid transfer has valuable rights against the transferee whose name is substituted for his own.² Presumably, he may sue him in an action in the nature of trover for conversion of the shares.³ Certainly he may recover from him any dividends paid to him by the company.⁴ These rights of course exist only in cases in which the true owner is not estopped from denying the validity of the transfer in question. It has been held that in an action of trover by an alleged owner of shares against a person whose name has been registered in his stead, a judgment in an action by the plaintiff against the corporation whereby the corporation was exonerated from liability to the plaintiff for registering the transfer is admissible in evidence to prove that the plaintiff is without title to the shares claimed by him.⁵

§ 941. **Liability to the Company.** — Where the company has treated a transferee as shareholder under a mistaken belief that the transfer is genuine, any dividends paid to him as shareholder may be recovered back by the company as money paid under mistake of fact.⁶ Of course, the transferee cannot be required to repay the dividends to the corporation and also to pay the

¹ *Pennsylvania R. R. Co.'s Appeal*, 86 Pa. St. 80. charged with notice of the invalidity of his title).

² Cf. *Blaisdell v. Bohr*, 68 Ga. 56; But see *O'Dwyer v. Verdon*, 115 N. Y. App. Div. 37.
Harrison v. Pryse, Barnard. Ch. 324.

³ But see *Pratt v. Taunton Copper Co.*, 123 Mass. 110; 25 Am. Rep. 37. ⁴ *Johnston v. Renton*, 9 Eq. 181; *Hildyard v. South Sea Co.*, 2 P. Wms. 76.

⁵ *Anderson v. Nicholas*, 28 N. Y. 600 (where the transferee was charged with notice of the invalidity of his title). ⁶ *O'Dwyer v. Verdon*, 115 N. Y. App. Div. 37. ⁷ *Foster v. Tyne Pontoon, etc. Co.*, 63 L. J. Q. B. 50.

amount of them to the true owner of the shares. Recovery by the company would be a bar to a claim by the true owner against the transferee. And the amount recovered by the company from the transferee would be held in trust for the true owner of the shares. Of course, if the company be estopped from denying the validity of the transfer, as we have seen above may be the case, the transferee would be under no liability to the company. As the transferee or his agent usually presents the transfer for registration, the transferee often incurs the liability attaching to any person who presents an invalid transfer for registration — a matter which is considered below.¹

§ 942. **Liability of Person who presents invalid Transfer for Registration.** — A person who presents a transfer for registration impliedly asserts its genuineness. If the transfer is in fact forged, he is liable to the company for any damages it may suffer in acting thereon although he was quite ignorant of the forgery;² and if the transfer is executed by an agent or attorney, he is liable unless the agent or attorney had in fact authority to execute the same.³ The same rules apply where the transfer is invalid because of the lunacy or other incapacity of the transferor.⁴

If after the registration of a forged transfer the shares are assigned to a *bona fide* purchaser, and the person whose name was forged calls upon the company to cancel the transfer and issue another certificate to him, the company may give notice of this claim to the person who presented the forged transfer, and

¹ *Infra*, § 942.

² *Sheffield Corporation v. Barclay* (1905), A. C. 392 (overruling the judgment of Lindley, J., in *Anglo-American Tel. Co. v. Spurling*, 5 Q. B. D. 188); *Starkey v. Bank of England* (1903), A. C. 114; *Clarkson Home v. Missouri, etc. Ry. Co.*, 182 N. Y. 47; 74 N. E. 571; *Boston, etc. R. R. Co. v. Richardson*, 135 Mass. 473; *Hildyard v. South Sea Co.*, 2 P. Wms. 76 (disapproved in, and perhaps overruled by *Ashby v. Blackwell*, Ambler 503); *Bank of Eng-*

land v. Cutler (1907), 1 K. B. 889 (where a person who introduced the transferor for the purpose of identifying him was held to warrant his identity with the registered owner).

³ *Clarkson Home v. Missouri, etc. Ry. Co.*, 182 N. Y. 47; 74 N. E. 571 (depending partly on a rule of the stock exchange).

⁴ *McLaughlin v. Daily Telegraph Newspaper*, 1 Comm. L. R. (Aust.) 243, 280 (headnote inadequate).

may require him to pay its costs in resisting the claim as well as the amount which the company may have expended in purchasing shares in the market in order to respond to the claim.¹ So, if the company pays dividends to the transferee who presented the forged transfer, and is afterwards compelled to cancel the transfer, reinstate the true owner, and pay the dividends to him, the amount of the dividends may be recovered back from the person who presented the forged transfer.² *A fortiori*, the company may on bill in equity require the person who presented the transfer to surrender the share-certificate which the company issued to him and the validity of which in the hands of a *bona fide* purchaser the company would be estopped from denying.³

The liability of the person who presents an invalid transfer for registration is founded not merely on an implied warranty of the validity of the transfer, in which case the statute of limitations would begin to run forthwith, but rather upon an implied contract of indemnity, so that the statute of limitations does not begin to run until the company suffers a loss by being compelled to respond to the true owner of the shares in damages or otherwise.⁴ On the other hand, where the company registers a forged transfer of stock and the stock is afterwards transferred by the forger to a *bona fide* purchaser, the company upon discovering the forgery is not bound to strike out the forged transfer, and remove the name of the *bona fide* purchaser from the register, but may purchase stock in the market for the original owner without waiting for the *bona fide* purchaser to set up a claim by estoppel, and may thereupon sue the person who presented the forged transfer for indemnity against the loss sustained on the purchase of the stock in the market.⁵

§ 943. **Liability of Transferor in and about Registration of Transfer.** — As will be more fully explained below, to procure the registration of a transfer is the part of the transferee rather

¹ *Boston, etc. R. R. Co. v. Richardson*, 135 Mass. 473.

² *Hildyard v. South Sea Co.*, 2 P. Wms. 76 (disapproved in and perhaps overruled by *Ashby v. Blackwell*, Ambler 503); *Hambleton v. Central Ohio R. R. Co.*, 44 Md. 551.

³ *Brown v. Howard Fire Ins. Co.*, 42 Md. 384; 20 Am. Rep. 90.

⁴ *Sheffield Corporation v. Barclay* (1905), A. C. 392, 404-405 (headnote inadequate).

⁵ *Bank of England v. Cutler* (1907), 1 K. B. 889.

than of the transferor.¹ It follows that the transferor is under no active duties in the matter. He is, however, bound to do nothing to interfere with the transferee in his endeavor to have the transfer registered. If at his instance the company refuses or postpones the registration of the transfer, he is liable to the transferee for all damages sustained in consequence of such refusal or postponement.² This liability is not strictly contractual but is imposed by the law. Indeed, it sounds rather in tort than in contract. Consequently, it may be enforced by a person with whom the transferor, the defendant, has entered into no direct contractual relations — for example, by the ultimate purchaser of a blank transfer which has passed from hand to hand and which the purchaser has filled up with his own name, or by a person claiming under a transfer which is for some reason defective but the validity of which the transferor is estopped from denying.³

§ 944. **Liability of Transfer Agent or Clerk.** — The agent who negligently or fraudulently registers an invalid transfer, or issues a share-certificate to a person who is not entitled to it, is obviously liable to the corporation for so doing. In most cases, the culpable agent is financially irresponsible, so that this remedy is rarely resorted to. Sometimes, however, the corporation appoints some bank⁴ or trust company its transfer agent, and delegates to it the duty of registering transfers and issuing certificates. In such cases, the bank or trust company is liable for the negligent or fraudulent registration of an invalid transfer or for the issuing of a certificate to a person not entitled thereto;⁵ even though due care may have been used in the selection of the sub-agent or clerk.⁶ Where the transfer agent's sub-agent has engaged in a systematic fraudulent issue of certificates to persons who were not entitled to them, the entire liability of the transfer agent may be enforced in one equity suit without resorting to separate actions at law.⁷ Such a bill

¹ *Infra*, § 971.

⁵ *Bank of Kentucky v. Schuylkill*

² *Hooper v. Herts* (1906), 1 Ch. 549. *Bank*, 1 Pars. Eq. Cas. (Pa.) 180.

⁶ *Bank of Kentucky v. Schuylkill*

³ *Hooper v. Herts* (1906), 1 Ch. 549. *Bank*, 1 Pars. Eq. Cas. (Pa.) 180,

⁴ As to the corporate power of a

239-244.

bank to act as such agent, see *Bank*

⁷ *Bank of Kentucky v. Schuylkill*

of Kentucky v. Schuylkill Bank, 1 Pars. Eq. Cas. (Pa.) 180, 236-239.

Bank, 1 Pars. Eq. Cas. (Pa.) 180.

may be filed even before the corporation has been compelled to discharge any liability to the holders of the wrongfully issued certificates.¹ On the other hand, the duty of the transfer agent or clerk to register a valid transfer when presented is owing to his principal alone; and for mere nonfeasance in refusing or neglecting to register a valid transfer when presented, the transfer agent is not liable in damages either to the transferor or transferee.²

§ 945-§ 962. BY-LAWS AND EXPRESS REGULATIONS RESPECTING TRANSFERS.

§ 945. **Validity of By-laws relating to Transfers.** — The by-laws and conventional regulations of incorporated companies generally contain provisions relating to transfers of shares. The validity of these provisions is sometimes open to dispute; but with such questions, which are discussed in another place,³ we are not now concerned. For present purposes, the validity of the regulations may be assumed; and we shall accordingly confine ourselves to questions as to their construction, operation, and effect, assuming them to be valid.

§ 946-§ 948. *Regulations as to Form or Manner of Transfers.*

§ 946. **Mandatory Regulations.** — Regulations respecting the form or manner of transfers may of course be either mandatory or directory. General rules for determining whether any particular provision should be construed to be the one or the other are apt to be misleading rather than helpful. A provision that transfers must be by deed has been held to be mandatory, so as to invalidate an unsealed transfer.⁴ So a provision that transfers shall be executed by both transferor and transferee will prevent a transfer executed by the transferor only from passing a

¹ *Bank of Kentucky v. Schuylkill* shares by refusing to register transfers, 1 Pars. Eq. Cas. (Pa.) 180, for not sustainable).
244-245.

Cf. *Cooley v. Curran*, 104 N. Y.

² *Dunham v. City Trust Co.*, 101 Supp. 751.

N. Y. Supp. 87; *Cooley v. Curran*, 104 N. Y. Supp. 424 (action against company's president for converting

³ See supra, § 706-§ 711.

⁴ *Powell v. London & Provincial Bank* (1893), 2 Ch. 555; *Bishop v. Globe Co.*, 135 Mass. 132.

complete title.¹ Similarly, a provision that transfers shall be signed in the presence of an officer of the company or of two witnesses has been held to invalidate a transfer not so attested.²

§ 947. **Directory Regulations.** — On the other hand, a provision that a transfer should contain a true statement of the consideration upon which it was executed has been thought to be directory merely.³

§ 948. **Regulations that Shares shall be transferable only on Company's Books.** — A very common provision in American by-laws is that shares shall be transferable only on the books of the company. This provision is not treated separately in this work, because the transfer books of a corporation play so important a rôle in the matter of transfers of shares that it seemed inadvisable to relegate the consideration of their function to a sub-heading under the subject of by-laws and regulations affecting transfers of shares. Moreover, it has seemed to the writer that the actual effect of a regulation that shares shall be transferable only on the company's books is comparatively slight; that is to say, by statute or custom every incorporated company is required to keep a list or roll of its shareholders, and even where the regulations of the company do not expressly provide that transfers of shares shall be made only by entry on the company's books, the importance to a transferee of seeing that his name is properly entered on the company's books is only slightly less.

§ 949–§ 950. *Waiver by Company of Regulations intended for its Benefit.*

§ 949. **In general.** — Even where a provision regulating transfers is mandatory rather than directory, nevertheless if it be intended solely for the company's benefit or protection, non-compliance may be waived, and will be deemed to have been waived if the company with knowledge of the irregularity proceeds to register the transfer. Thus, although a provision that transfers shall be executed by both parties be mandatory and not merely directory, yet if the company accept as valid a transfer executed by the transferor only, and recognize the

¹ *Ortigosa v. Brown*, 38 L. T. 145.

² *Powell v. London & Provincial*

³ *Dane v. Young*, 61 Me. 160.

Bank (1893), 2 Ch. 555, 560 (semble).

transferee as shareholder, the irregularity will be deemed waived and cured.¹ So a provision that every transferee of shares must sign the by-laws of the company may be waived by issuing a share-certificate to the transferee and paying him dividends.²

§ 950. **Waiver of Restrictions on Shareholder's Right of Alienation.** — This same principle applies to restrictions upon the right of a shareholder to transfer his shares: they may be waived by registering the transfer and treating the transferee as a shareholder.³ For instance, a provision that an officer of the company shall not alienate his qualification shares does not invalidate a transfer made with company's consent.⁴ So, a statutory provision that no shareholder who is indebted for calls upon his shares shall be entitled to transfer any of his shares, does not invalidate such a transfer if the company waives the irregularity by registering the transferee as a shareholder,⁵ unless the registration of the transfer was done by mistake, in which case it may be stricken out and the transferor's name restored.⁶ And *a fortiori* if the registration of the transfer be procured by fraudulent mis-representation of the transferor, the company may strike out the name of the transferee and restore that of the transferor.⁷ Moreover, a provision that no officer of a bank shall hold shares in the bank without the consent of the directors is waived by paying dividends annually to an officer who has purchased shares, even though the transfer when presented for registration was never actually registered.⁸

§ 951-§ 952. *Regulations authorizing Company to reject Transfers deemed inimical to its Interests.*

§ 951. **Whether By-laws prescribing such Regulations are Valid.** — A common provision in England vests in the company

¹ *Taurine Co.*, 25 Ch. D. 118. *Ass'n v. Griffiths*, 1 Cababé & Ellis, 15. (semble).

Cf. *Burnes v. Pennell*, 2 Ho. Lds. Cas. 497.

² *People's Home Savings Bank v. Rickard*, 139 Cal. 285; 73 Pac. 858.

³ *People's Home Savings Bank v. Rickard*, 139 Cal. 285; 73 Pac. 858.

Cf. *Royal British Bank*, 26 L. J. Ch. 545.

⁴ *London & Westminster Supply*

⁵ *Ex parte Littledale*, 9 Ch. 257.

Cf. *Chambersburg Ins. Co. v. Smith*, 11 Pa. St. 120; *Watson v. Eales*, 23 Beav. 294. See also *infra*, § 957.

⁶ *Anderson's Case*, 8 Eq. 509.

⁷ *Williams' Case*, 9 Eq. 225 n.;

Payne's Case, 9 Eq. 223.

⁸ *Earle v. Coyle*, 97 Fed. 410; 38

C. C. A. 226.

or its directors a power of rejecting a transfer that they may deem prejudicial to the interests of the corporation. Great doubt exists whether such a provision can in America be enacted by mere by-law.¹ Certainly, however, the law ought to provide some method by which a corporation could be formed subject to such a regulation. The business of many corporations is such that unless entire harmony prevails in the management the interests of all the members may suffer. If the organizers of a corporation desire to form the company upon a plan which will prevent any member from alienating his shares to a person whom the other shareholders may not deem a desirable associate, the law should furnish the means by which they can do so. It is a reproach to the jurisprudence of the United States if such a plan is not feasible without the aid of special legislation.

§ 952. **Operation and Effect of such Regulations where Valid.** — The effect of a valid regulation requiring transfers to be approved by the directors of the company is that no transfer is valid at law — the rule in equity will be considered presently — until it has received such approval.² The approval may, however, be implied from the fact of registration.³ A court of law may by mandamus compel the directors to consider a transfer,⁴ but cannot control the exercise of their discretion even though they act arbitrarily, unfairly, and oppressively.⁵ A court of equity, however, if the rejection of the transfer be shown to be arbitrary and not *bona fide*, has power to override the determination and to direct that the transfer be registered as if it had been approved instead of being rejected.⁶

Even in equity, the company's rejection of the transfer is conclusive, however erroneous it may be, unless bad faith be proved.⁷ Moreover, the decision reached by the company in rejecting the transfer is presumed to have been reached *bona fide*.⁸ This

¹ Supra, § 706–§ 711.

² *Nicol's Case*, 3 De G. & J. 387, 433 (semble); *Ex parte Penny*, 8 Ch. 446.

³ *Ex parte Bentinck*, 1 Megone 23. But see *Battie's Case*, 39 L. J. Ch. 391.

⁴ *Ex parte Penny*, 8 Ch. 446 (semble).

⁵ *Ex parte Penny*, 8 Ch. 446.

⁶ *Ex parte Penny*, 8 Ch. 446; Times L. R. 314.

Bell Bros. 65 L. T. 245; *Robinson v. Chartered Bank*, 1 Eq. 32.

⁷ *Yuruari Co.*, 6 Times L. R. 119; *Hannan's King Mining Co.*, 14 Times L. R. 314; *Ex parte Penny*, 8 Ch. 446.

But cf. *Hubbard v. Manhattan Trust Co.*, 87 Fed. 51, 57–58; 30 C. C. A. 520.

⁸ *Hannan's King Mining Co.*, 14

is true even where no reasons are assigned by the company for the rejection¹ although the right to reject a transfer is confined to certain named grounds.² If, however, reasons for rejecting the transfer are assigned, the reasons so specified must be adequate and furnish some just ground for the rejection; for otherwise a court of equity will deem the rejection unjustifiable, treating the rejection of the transfer for certain specified reasons as equivalent to an approval in all other respects — an approval subject to an inadmissible objection.³ It makes no difference, therefore, that another ground for rejecting the transfer can be suggested upon which if the directors had acted, the court would not have felt justified in overruling their determination.⁴ A refusal to approve any transfer at all, thus virtually making the shares inalienable, is of course deemed arbitrary.⁵ So, an objection to a person for whom the transferee is acting as trustee has been held to be insufficient cause for rejecting the transfer;⁶ but this decision, if it be law, certainly greatly reduces the advantages to the company from a requirement that transfers shall be subject to the approval or rejection of the corporation. In Australia, a refusal to approve the transfer because of a belief that the transferee would vote for a certain person as director has been held unjustifiable⁷ — a decision which likewise greatly reduces the value of the company's discretionary power. A refusal to register a transfer because of a desire to keep the control of the company in a particular family is unjustifiable.⁸ And a refusal because the transferor is indebted to the company is also improper under a general power to reject any transfer;⁹ for the effect would be, virtually, to

¹ *Ex parte Penny*, 8 Ch. 446; *Yuruari Co.*, 6 Times L. R. 119.

But see *New Lambton Land & Coal Co. v. London Bank*, 1 Comm. L. R. (Aust.) 524; *Alfred Shaw & Co.*, 21 Vict. L. R. 599 (where the court drew unfavorable inferences from the refusal of the directors on cross examination to disclose their reasons).

² *Coalport China Co.* (1895), 2 Ch. 404.

³ *Bell Bros.*, 65 L. T. 245, 249.

⁴ *Bell Bros.*, 65 L. T. 245, 248-249.

⁵ *Robinson v. Chartered Bank*, 1 Eq. 32; *New Lambton Land & Coal Co. v. London Bank*, 1 Comm. L. R. (Aust.) 524.

⁶ *Bell Bros.*, 65 L. T. 245, 248; *New Lambton Land & Coal Co. v. London Bank*, 1 Comm. L. R. (Aust.) 524, 545.

Cf. *Robinson v. Chartered Bank*, 1 Eq. 32; *Moffat v. Farquahar*, 7 Ch. D. 591.

⁷ *Alfred Shaw & Co.*, 21 Vict. L. R. 599 (headnote inadequate).

⁸ *Bell Bros.*, 65 L. T. 245.

⁹ *Pinkett v. Wright*, 2 Hare 120;

give the company a lien on the shares for the indebtedness of the holder — a result which requires an express regulation.¹ The justifiableness *vel non* of a rejection of a transfer must be judged according to facts existing at the time the transfer is presented to the company, and cannot be affected by any subsequent occurrences.²

The company may rescind an approval of a transfer which was procured by fraudulent misrepresentations of the transferor³ or by bribing the directors of the company;⁴ but it seems that the mere fact that the transferor is a member of the board of directors and participates in the approval of the transfer will not invalidate the approval.⁵

An approval of a transfer in consideration of the transferor's guarantee of any calls that might be payable by the transferee is valid so that the transferor is no longer liable *as a shareholder*, although he may be liable upon his contract.⁶

Sometimes the right to reject a transfer is conditional upon a substitute being found who will take the shares at the same price as the proposed transferee; and in such a case the company has no right to reject a transfer without first finding a substitute.⁷ Sometimes, if a transfer is rejected the directors are bound to purchase the shares on behalf of the company; but even under such a regulation they cannot be required to purchase the shares if the company has no funds available for the purpose.⁸

§ 953. Regulations authorizing Directors to prescribe Form of Transfers. — Sometimes, the board of directors without being invested with any discretion absolutely to reject a transfer, are empowered to prescribe the form of transfer. Under such a

New Lambton Land & Coal Co. v. London Bank, 1 Comm. L. R. (Aust.) 284. 524, 544. ⁴ *Bennett's Case*, 5 De G. M. & G. 284.

¹ See *infra*, § 954, § 955.

² *Cawley & Co.*, 42 Ch. D. 209; See *infra*, § 1602.

Ex parte Rudolph, 11 W. R. 806.

Cf. *Nation's Case*, 3 Eq. 77.

³ *Williams' Case*, 9 Eq. 225n;

Payne's Case, 9 Eq. 223.

Cf. *Battie's Case*, 39 L. J. Ch. 391.

Cf. *Eyre's Case*, 31 Beav. 177.

⁵ *Ex parte Littledale*, 9 Ch. 257.

⁶ *Harrison's Case*, 6 Ch. 286.

⁷ *Chappell's Case*, 6 Ch. 902.

⁸ *Taft v. Harrison*, 10 Hare 489.

power, the directors cannot arbitrarily reject a form of transfer which they have approved in other cases.¹

§ 954. **Regulations authorizing Directors to decline to register Transfer by Shareholder who is indebted to the Corporation.** — Sometimes, provisions are found entitling the company to decline to allow a transfer in any case where the transferor is indebted to the corporation. Such a provision does not render a transfer by a shareholder who is indebted to the company absolutely void; for the transferor may pay off the indebtedness, and then the transfer should be registered.² Hence a transfer by a shareholder who was indebted to the company passed all his interest, and removed his common law incompetency to testify in an action to which the corporation was party.³ Even where the regulations provide that a transfer disapproved by the directors shall be void, a refusal to register a transfer on the ground that the transferor is indebted to the company is not such a disapproval as will render the transfer utterly void.⁴ A provision authorizing the company to decline to register a transfer by a shareholder who is indebted to it, applies to an indebtedness of any kind and not merely to a debt for calls or some other debt due by the transferor *qua* shareholder;⁵ but does not apply to the potential liability for future calls which have not been actually made at the time of the transfer.⁶ The point of time at which the indebtedness must exist is the time of presentation of the transfer for record and not the time of execution of the transfer.⁷ If the shareholder is indebted to the

¹ *Poole v. Middleton*, 29 Beav. *etc. Co.*, 4 Ala. 652 (debt due by firm of which shareholder was

² *Ex parte Harrison*, 28 Ch. D. member). 363.

³ *Bank of Utica v. Smalley*, 2 *lom*, 49 Ala. 558; *Sproul v. Standard Cow.* (N. Y.) 770, 778; 14 Am. *Glass Co.*, 201 Pa. 103; 50 Atl. 1003 Dec. 526.

⁴ *Ex parte Harrison*, 28 Ch. D. 363. See *supra*, § 952.

⁵ *Ex parte Stringer*, 9 Q. B. D. 436; *Nat. Bank v. Rochester Tumbler Co.*, 172 Pa. St. 614; 33 Atl. 748; 484.

Kahn v. Bank of St. Joseph, 70 Mo. 262; *Mechanics Bank v. Earp*, 4 Rawle (Pa.) 384 (where the debt in question was owing by a firm of which the shareholder was a member); *Cunningham v. Ala. Life Ins., Bank*, 111 Mich. 306; 69 N. W. 645.

⁶ *Cawley & Co.*, 42 Ch. D. 209; *Ex parte Rudolph*, 11 W. R. 806; *Hall v. U. S. Ins. Co.*, 5 Gill (Md.) 484.

⁷ *Michigan Trust Co. v. State Bank*, 111 Mich. 306; 69 N. W. 645.

company, and the company is indebted to the shareholder on another and entirely separate account, the company may decline to register a transfer even though upon a full settlement of accounts a balance would have been due to the shareholder.¹

§ 955-§ 961. *Liens on Shares for Debts of Holders to the Company.*

§ 955. **When Lien exists.** — Sometimes, the company has a lien upon its several shares for debts due to it by the holders thereof. Such a lien does not exist apart from some express provision either in some statute or in the company's regulations.² It has been said that a statute giving the company a lien upon its shares for debts of the holders should be strictly construed.³ It may be argued that a lien is something more than a mere power to decline to register a transfer by a shareholder who is indebted to the company; and consequently it is held in England and in Ireland that a provision vesting such a power in the company does not create a lien upon the shares.⁴ But the American cases in which the point has arisen generally hold that such a provision does give the company a lien.⁵ It has been held that no lien is created by a provision for forfeiture of the shares in case the shareholder fails to pay a debt owing to the company.⁶ On the other hand, a provision that,

¹ *Mechanics Bank v. Earp*, 4 Rawle (Pa.) 384, 392.

² *Merchants' Bank v. Shouse*, 102 Pa. St. 488; *Heart v. State Bank*, 2 Dev. Eq. (N. Car.) 111; *Mass. Iron Co. v. Hooper*, 7 Cush. (Mass.) 183; *Lankershin Ranch Land, etc. Co. v. Herberger*, 82 Cal. 600; 23 Pac. 134; *Gemmell v. Davis*, 75 Md. 546; 23 Atl. 1032; 32 Am. St. Rep. 412; *Steamship Dock Co. v. Heron's Admx.*, 52 Pa. St. 280; *Herrick v. Humphrey Hardware Co.* (Nebr.), 103 N. W. 685.

Cf. *Re Rowe* (1904), 2 K. B. 489.

As to the validity of by-laws creating such liens, see supra, § 706-§ 711.

³ *Boyd v. Redd*, 120 N. Car. 335; 27 S. E. 35; 58 Am. St. Rep. 792.

⁴ *Kingstown Yacht Club* (1888), 21 L. R. Ir. 199; *Dunlop v. Dunlop*, 21 Ch. D. 583.

⁵ *Kenton Ins. Co. v. Bowman*, 84 Ky. 430; 1 S. W. 717; *Farmers' Bank of Maryland's Case*, 2 Bland (Md.) 394; *Wetherell v. Thirty-first Street, etc. Ass'n*, 153 Ill. 361; 39 N. E. 143.

Cf. *Brent v. Bank of Washington*, 10 Pet. 596 (headnote inadequate); *Tete v. Farmers', etc. Bank*, 4 Brewst. (Pa.) 308; *Sproul v. Standard Glass Co.*, 201 Pa. 103, 109-110; 50 Atl. 1003.

But see *Brent v. Bank of Washington*, 2 Cranch C. C. 517.

⁶ *Dunlop v. Dunlop*, 21 Ch. D. 583; *Dearborn v. Washington Sav. Bank*, 18 Wash. 8; 50 Pac. 575;

in case of non-payment of the debt, the company may sell the debtor's shares and retain the amount of the debt out of the proceeds does create a lien.¹

§ 956. **Nature and Effect of Lien in general.** — A lien upon shares for a debt due by the holder to the company is an equitable charge, and as such subject, in general, to all the rules, whether prescribed by statute or existing apart from statute, applicable to charges of that description. Hence, where the company has a lien upon its shares for the debts of the holder a loan to a shareholder is deemed a loan upon security.² So, the lien gives priority in respect to the shares covered thereby even over a debt owing to the sovereign.³ Moreover, a surety of the shareholder, on paying the debt, is entitled to be subrogated to the company's lien.⁴ The existence of the lien may be offered in evidence in reduction of damages in a suit against the company by the shareholder in the nature of an action for conversion of the shares.⁵ If the company at the time of making the loan has notice of another existing equitable charge upon the shares, the company's lien will be postponed to the prior charge.⁶ If the lien be created by statute, even a *bona fide* pur-

Small v. Herkimer Mfg. Co., 2 N. Y. 330.

But see *Re Jennings* (1851), 1 Ir. Ch. 236; *Great Northern Ry. Co. v. Kennedy*, 4 Exch. 417, 425.

¹ *Deering v. Hibernian Banking Co.*, 16 W. R. 578; *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424.

But see *Dearborn v. Washington Savings Bank*, 18 Wash. 8; 50 Pac. 575.

² *Everitt v. Automatic Weighing Machine Co.* (1892), 3 Ch. 506.

Cf. *Farmers' Bank of Maryland's Case*, 2 Bland (Md.) 394.

But see *German Security Bank v. Jefferson*, 10 Bush (Ky.) 326, holding that the company after exhausting the shares cannot prove in competition with the debtor's general creditors until the latter have been made equal out of the general estate. *Sed quære.*

³ *National Bank of Wales* (1899), 2 Ch. 629 (affirmed *sub nom. Dovey v. Cory* (1901), A. C. 477).

Cf. *Evansville Nat. Bank v. Met-*

ropolitan Nat. Bank, 2 Biss. 527; *First Nat. Bank v. Hartford, etc. Ins. Co.*, 45 Conn. 22.

⁴ *Brent v. Bank of Washington*, 10 Pet. 596.

⁵ *Klopp v. Lebanon Bank*, 46 Pa. St. 88; *Petersburg, etc. Ins. Co. v. Lumsden*, 75 Va. 327; *Re Morrison*, 10 N. B. R. 105 (semble); *Young v. Vough*, 23 N. J. Eq. 325.

But cf. *Cross v. Phoenix Bank*, 1 R. I. 39. See also *West Branch Bank v. Armstrong*, 40 Pa. St. 278.

⁶ *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424.

⁷ *Bradford Banking Co. v. Briggs*, 12 A. C. 29; *Nesmith v. Washington Bank*, 6 Pick. (Mass.) 324; *Birmingham Trust, etc. Co. v. La. Nat. Bank*, 99 Ala. 379; 13 So. 112; 20 L. R. A. 600; *Curtice v. Crawford County Bank*, 118 Fed. 390.

See also *infra*, § 960.

chaser of the shares claiming under a transfer endorsed on the share-certificate would take subject to the lien;¹ for he has constructive notice. But where a mere by-law of an American corporation attempts to create a lien, it will not, according to the prevalent view, be valid as against a *bona fide* purchaser of the certificate, even if the by-law have any effect at all — a point on which the authorities are not unanimous.² A purchaser of the shares at a sale under an execution against the shareholder takes subject to the lien.³ A lien created by statute for a particular class of debts will have priority over a lien for all debts without distinction created by the by-laws.⁴ The company's lien is a general one; and hence if the company takes other security, it must exhaust the same before resorting to the shares.⁵ The lien protects all debts owing to the company equally, without regard to the date when they were contracted. Hence a surety for the debt first contracted has no equity, it has been held, to have the shares applied to the discharge of that debt rather than of other debts subsequently contracted by the shareholder;⁶ but it is submitted that a different decision would have been more just to the surety without in any way diminishing the right of the corporation and without doing violence to any rule of law. If some of the shares are assigned to a *bona fide* purchaser, although he takes subject to

¹ *Farmers' Bank of Md. v. Iglehart*, 6 Gill (Md.) 50; *Dorr v. Life Ins. Clearing Co.*, 71 Minn. 38; 73 N. W. 635; 70 Am. St. Rep. 309; *First Nat. Bank v. Hartford, etc. Ins. Co.*, 45 Conn. 22, 35-36; *Bohmer v. City Bank*, 77 Va. 445; *Union Bank v. Laird*, 2 Wheat. 390 (where the lien was created by a special act of incorporation); *Hammond v. Hastings*, 134 U. S. 401; 10 Sup. Ct. 727 (where the lien was created by a general statute); *Wright Lumber Co. v. Hixon*, 105 Wisc. 153; 80 N. W. 1110, 1135; *Reese v. Bank of Commerce*, 14 Md. 271; 74 Am. Dec. 536; *Curtice v. Crawford County Bank*, 110 Fed. 830.

² See *supra*, § 706.

³ *Oliphint v. Bank of Commerce*, 60 Ark. 198; 29 S. W. 460; *Springfield Wagon Co. v. Bank of Bates-*

ville, 68 Ark. 234; 57 S. W. 257; *Mechanics Bank v. Merchants Bank*, 45 Mo. 513; 100 Am. Dec. 388; *Tuttle v. Walton*, 1 Ga. 43; *Farmers', etc. Bank v. Haney*, 87 Iowa 101; 54 N. W. 61.

Aliter where the company's debt had not been contracted at the time of the levy: *Pilot v. Johnson*, 33 La. Ann. 1286; *Geyer v. Western Ins. Co.*, 3 Pittsb. (Pa.) 41.

Cf. *Bryon v. Carter*, 22 La. Ann. 98; *Owens v. Atlanta Trust, etc. Co.*, 122 Ga. 521; 50 S. E. 379 (where the purchaser at the execution sale had notice of the company's claim).

⁴ *Petersburg, etc. Ins. Co. v. Lumsden*, 75 Va. 327.

⁵ *Dunlop v. Dunlop*, 21 Ch. D.

583.

⁶ *Cross v. Phoenix Bank*, 1 R. I.

39.

the company's lien (unless the company waive the lien by registering the transfer or otherwise), still the effect of the assignment, according to the doctrine of marshalling, is to charge the lien in the first instance upon the shares retained by the transferor, to the exoneration of the transferred shares;¹ and this rule applies even as against judgment creditors of the transferor who have levied upon the shares remaining in his name.² Where the lien is for the full value of the shares, the company may, it has been held, upon getting the share-certificate in its possession, lawfully refuse to redeliver it until the indebtedness be adjusted.³

§ 957. **Waiver of Lien.** — According to some authorities and the reason of the thing, the company by registering a transfer of shares waives any lien thereon for a debt of the transferor.⁴ It would follow, therefore, that the company may always refuse to register a transfer of shares upon which it has a lien for moneys owing by the transferor,⁵ even though the transferee may have acquired the certificate in the open market without knowledge of the debt for which the lien is claimed.⁶ On the other hand, in one or two states, the courts have held that while even a *bona fide* purchaser of the certificate takes in subordination to the lien, yet the company may be required to register the transfer subject to the lien.⁷ Transmission of shares by death

¹ *Gray v. Stone*, 69 L. T. 282.

² *Gray v. Stone*, 69 L. T. 282.

³ *Bishop v. Globe Co.*, 135 Mass. 132, 138 (headnote inadequate).

Cf. *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424, 429-430.

⁴ *Hodges v. Planters' Bank*, 7 G. & J. (Md.) 306; *Downer's Adm'r v. Zanesville Bank*, Wright (Oh.) 477; *Hill v. Pine River Bank*, 45 N. H. 300; *National Bank v. Watertown Bank*, 105 U. S. 217 (headnote inadequate).

Cf. *Hall v. U. S. Ins. Co.*, 5 Gill (Md.) 484; *Moore v. Bank of Commerce*, 52 Mo. 377; *Petersburg, etc. Ins. Co. v. Lumeden*, 75 Va. 327; *Just v. State Bank*, 94 N. W. 200; 132 Mich. 600; *London, Paris & American Bank v. Aronstein*, 117 Fed. 601, 606; 54 C. C. A. 663 (reg-

istration of shares in name of executor of deceased shareholder not a waiver of lien). See also *supra*, § 950.

But see *Re Bachman*, 2 Fed. Cas. 310; *Dobbins v. Walton*, 37 Ga. 614; 95 Am. Dec. 371.

⁵ *Jennings v. Bank of California*, 79 Cal. 323; 21 Pac. 852; 12 Am. St. Rep. 145; 5 L. R. A. 233; *Tete v. Farmers', etc. Bank*, 4 Brewst. (Pa.) 308.

Cf. *W. Key & Son* (1902), 1 Ch. 467.

⁶ See *supra*, § 956.

⁷ *Craig v. Hesperia, etc. Co.*, 113 Cal. 7; 45 Pac. 10; 54 Am. St. Rep. 316; 35 L. R. A. 306; *Herdegen v. Cotzhausen*, 70 Wisc. 589; 36 N. W. 385.

or bankruptcy does not affect the lien; and consequently the lien is not waived by registering as shareholder the executor or the trustee.¹

The fact that the person in charge of the transfer books when a transfer is presented for registration promises to make the transfer and issue a new certificate will not amount to a waiver of the lien or estop the company from relying thereon, where the agent in charge of the books was not shown to have authority to do more than receive requests and communicate with the proper officers.² Even a letter from the company explicitly stating that the shares are unencumbered will not, it has been held, estop the corporation from asserting a lien some twelve months afterwards.³ On the other hand, if the company leads the transferee to believe that the lien does not exist or will not be insisted upon, thereby lulling him into security and causing him to alter his position, the lien cannot subsequently be set up against him.⁴

An express mortgage or pledge of shares to the company would seem to supersede the general lien.⁵ But the fact that the company has taken other security for the debt, such as a mortgage of land, does not amount to a waiver of the lien.⁶

A by-law providing that a shareholder desiring to sell his shares shall give the company ten days to find a purchaser, and after the expiration of that time may sell at pleasure, does not amount to a waiver of a lien secured to the company by statute.⁷

The failure of the company, when the shareholder's debt is

¹ See *infra*, § 977, § 983 and *supra*, p. 771, n. 4.

² *Bishop v. Globe Co.*, 135 Mass. 132. Cf. *Kenton Ins. Co. v. Bowman*, 84 Ky. 430; 1 S. W. 717.

³ *Planters', etc. Ins. Co. v. Selma Savings Bank*, 63 Ala. 585, 594-595.

⁴ *National Bank v. Watontown Bank*, 105 U. S. 217; *Moore v. Bank of Commerce*, 52 Mo. 377; *Des Moines, etc. Trust Co. v. Des Moines Bank*, 97 Iowa 668; 66 N. W. 914; *Oakland, etc. Bank v. State Bank*, 113 Mich. 284; 71 N. W. 453; 67 Am. St. Rep. 463 (where by statute the directors alone had power to waive

the lien and yet an estoppel was raised by representations of the cashier); *St. Paul Nat. Bank v. Life Ins. Clearing Co.*, 71 Minn. 123; 73 N. W. 713.

⁵ *McLean v. Lafayette Bank*, 3 McLean 587, 617-619.

⁶ *Kenton Ins. Co. v. Bowman*, 84 Ky. 430; 1 S. W. 717; *Union Bank v. Laird*, 2 Wheat. 390; *German Nat. Bank v. Ky. Trust Co.*, 40 S. W. 458; 19 Ky. Law Rep. 361.

Cf. *Dunlop v. Dunlop*, 21 Ch. D. 583; *Re Morrison*, 10 N. B. R. 105.

⁷ *Citizens Bank v. Kalamazoo Co. Bank*, 111 Mich. 313; 69 N. W. 663.

contracted, to insist upon a surrender of the share-certificate does not amount to a waiver of the lien;¹ and, indeed, one may well doubt whether it could lawfully have demanded a surrender of the certificate. A statement in a share-certificate that the shares may be transferred on the company's books on surrendering the certificate does not amount to a waiver of the lien or estop the company from asserting it against a *bona fide* purchaser of the certificate.² On the other hand, if the regulations which create the lien provide that a copy of the by-law shall be endorsed on the certificate, an omission of the endorsement from the certificate has been held a waiver of the lien.³

§ 958. **Loss of Lien otherwise than by Waiver.** — The repeal of the statute which gave the lien will not divest the lien as to debts contracted prior to the repeal.⁴ The lien is not lost because the debt secured is barred by limitations.⁵

§ 959. **What is subject to the Lien.** — The lien covers any moneys distributable or payable to the shareholder on account of his shares in liquidation or amalgamation or consolidation proceedings.⁶ The lien extends to dividends payable on the shares; but the right to deduct a debt due from a shareholder from the amount of dividends payable to him may often be supported on ordinary principles of set-off even though the company have no lien.⁷ All shares owned by the debtor are subject to the lien, and the company cannot be required to

¹ *Bohmer v. City Bank*, 77 Va. 447; 24 S. W. 129; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330.
² *Union Bank v. Laird*, 2 Wheat. 390 (headnote inadequate); *Hammond v. Hastings*, 134 U. S. 401 (headnote inadequate); 10 Sup. Ct. 727; *Bank of Commerce v. Bank of Newport*, 63 Fed. 898, 902 (headnote misleading); 11 C. C. A. 484; *Platt v. Birmingham Axle Co.*, 41 Conn. 255.

³ *Union Bank v. Laird*, 2 Wheat. 390 (headnote inadequate); *Hammond v. Hastings*, 134 U. S. 401 (headnote inadequate); 10 Sup. Ct. 727; *Bank of Commerce v. Bank of Newport*, 63 Fed. 898, 902 (headnote misleading); 11 C. C. A. 484; *Nat. Bank of the Republic v. Rochester Tumbler Co.*, 172 Pa. St. 614; 33 Atl. 748; *Bohmer v. City Bank*, 77 Va. 445; *Reese v. Bank of Commerce*, 14 Md. 271; 74 Am. Dec. 536.

⁴ *Brinkerhoff-Farris Trust, etc. Co. v. Home Lumber Co.*, 118 Mo.

447; 24 S. W. 129; *Bank of Holly Springs v. Pinson*, 58 Miss. 421; 38 Am. Rep. 330.

⁵ *Wright Lumber Co. v. Hixon*, 105 Wisc. 153; 80 N. W. 1110, 1135.

⁶ *Geyer v. Western Ins. Co.*, 3 Pittsb. (Pa.) 41; *Farmers', etc. Bank v. Iglehart*, 6 Gill (Md.) 50.

⁷ *General Exchange Bank*, 6 Ch. 818.

⁸ *Gemmell v. Davis*, 75 Md. 546; 23 Atl. 1032; 32 Am. St. Rep. 412.

Cf. *Hagar v. Union Nat. Bank*, 63 Me. 509; *Bates v. N. Y. Ins. Co.*, 3 Johns. Cas. (N. Y.) 238; and *infra*, § 1361.

As to dividends in liquidation, see *Merchants' Bank v. Shouse*, 102 Pa. St. 488; *Bridges v. Nat. Bank of Troy*, 185 N. Y. 146.

release any of them from the lien, although the remainder might be more than sufficient to secure the debt.¹

§ 960. **What Debts are covered by the Lien.** — When the lien is expressed to be for “moneys due,” it extends to a debt for which time bills of exchange not yet mature have been taken;² for the taking of the bills merely suspends the remedy without making the original indebtedness any the less “due.” A lien for any *indebtedness* of a shareholder of course includes a debt which is not yet payable.³ Where one of the articles of association provides that the company shall have a lien upon its shares for debts “due” from the holders and another provides that the company may decline to register a transfer by any member who is “indebted” to it, the two articles being *in pari materia* must be construed together, and hence the company may not refuse to register a transfer unless the transferor’s indebtedness is “due” and payable.⁴ Ordinarily, only legal as distinguished from equitable claims against a shareholder are within the lien.⁵ The lien extends to an indebtedness of a trustee though not contracted on behalf of the trust estate,⁶ unless of course the company has notice of the trust before contracting the debt;⁷ but

¹ *Sewall v. Lancaster Bank*, 17 S. & R. (Pa.) 285 (semble).

Cf. *Cross v. Phoenix Bank*, 1 R. I. 39 (criticised, *supra*, § 956).

² *London, Birmingham, etc. Banking Co.*, 34 Beav. 332.

³ *Grant v. Mechanics Bank*, 15 S. & R. (Pa.) 140; *St. Louis, etc. Ins. Co. v. Goodfellow*, 9 Mo. 149.

Cf. *Sewall v. Lancaster Bank*, 17 S. & R. 285; *Pittsburgh, etc. R. R. Co. v. Clarke*, 29 Pa. St. 146.

⁴ *Stockton Iron Co.*, 2 Ch. D. 101.

Cf. *Michigan Trust Co. v. State Bank*, 111 Mich. 306; 69 N. W. 645; *Reese v. Bank of Commerce*, 14 Md. 271; 74 Am. Dec. 536.

But see *Downer’s Adm’r v. Zanesville Bank*, Wright (Oh.) 477; *Leggett v. Bank of Sing Sing*, 24 N. Y. 283 (where a lien for debts “due and payable” was held to cover a debt evidenced by a promissory note which had not reached maturity).

Cf. *Brent v. Bank of Washington*, 10 Pet. 596 (headnote inadequate).

⁵ *Child v. Hudson’s Bay Co.*, 2 P. Wms. 207, 209 (headnote inadequate). *Quære* as to claims for torts: *Hotchkiss, etc. Co. v. Union Nat. Bank*, 68 Fed. 76; 15 C. C. A. 264.

⁶ *New London Bank v. Brocklebank*, 21 Ch. D. 302.

Cf. *Young v. Vough*, 23 N. J. Eq. 325.

⁷ *Conant, Ellis & Co. v. Seneca County Bank*, 1 Oh. St. 298; *Bradford Banking Co. v. Briggs*, 12 A. C. 29; *Bank of America v. McNeil*, 10 Bush. (Ky.) 54; *Prince Investment Co. v. St. Paul, etc. Land Co.*, 68 Minn. 121; 70 N. W. 1079; *Nesmith v. Washington Bank*, 6 Pick. (Mass.) 324; *Birmingham Trust, etc. Co. v. Louisiana Nat. Bank*, 99 Ala. 379; 13 So. 112; 20 L. R. A. 600; *Mechanics Bank v. Seton*, 1 Pet. 299; *McLaughlin v. Bank of Victoria*, 20 Vict. L. R. 433.

it does not extend to debts owing to the company by a *cestui que trust* of shares.¹ Moreover, the lien applies to debts contracted by the registered owner of the shares even after a transfer by endorsement and delivery of the share-certificate,² unless the company has notice of the assignment;³ and by parity of reasoning debts contracted by a purchaser of shares who has not been registered as shareholder are not within the lien.⁴ But debts contracted by a shareholder in favor of a third person, and afterwards acquired by the company by assignment, are not covered.⁵ It has been held that debts contracted by the

¹ *Re Perkins*, 24 Q. B. D. 613. Cf. *Helm v. Swiggett*, 12 Ind. 194 (headnote inadequate).

But see contra: *Planters', etc. Ins. Co. v. Selma Savings Bank*, 63 Ala. 585; *Sabin v. Bank of Woodstock*, 21 Vt. 353.

Cf. *Lanier Lumber Co. v. Rees*, 103 Ala. 622; 16 So. 637; 49 Am. St. Rep. 57 (where the *cestui que trust* was a corporation which had no power to hold shares in another company, and for this reason its debt was held not to be secured by the lien).

² *Jennings v. Bank of California*, 79 Cal. 323; 21 Pac. 852; 12 Am. St. Rep. 145; 5 L. R. A. 233 (where the indebtedness secured was stated by the terms of the certificate to be "that of the person in whose name the stock stands on the books of the bank"); *Gibbs v. Long Island Bank*, 83 Hun (N. Y.) 92, 96 (headnote inadequate); 31 N. Y. Supp. 406; *Stafford v. Produce Exch. Banking Co.*, 61 Oh. St. 160; 55 N. E. 162; 76 Am. St. Rep. 371; *Mount Holly Paper Co.'s Appeal*, 99 Pa. St. 513; *Leggett v. Bank of Sing Sing*, 24 N. Y. 283, 287-288 (headnote inadequate); *Platt v. Birmingham Axle Co.*, 41 Conn. 255; *Reese v. Bank of Commerce*, 14 Md. 271; 74 Am. Dec. 536; *People's Bank of Talbotton v. Exchange Bank*, 116 Ga. 820; 43 S. E. 269; 94 Am. St. Rep. 144.

Cf. *Michigan Trust Co. v. State Bank*, 111 Mich. 306; 69 N. W. 645.

³ *Bank of America v. McNeil*, 10 Bush. (Ky.) 54; *White River, etc. Bank v. Capital, etc. Trust Co.*, 59 Atl. (Vt.) 197; 77 Vt. 123; 107 Am. St. Rep. 754 (where it was said that the lien of the company would attach to the interest of a pledgor who had pledged the shares and given notice to the company before the company's claim was contracted); *People's Bank of Talbotton v. Exchange Bank*, 116 Ga. 820; 43 S. E. 269; 94 Am. St. Rep. 144; *Curtice v. Crawford County Bank*, 110 Fed. 830 (burden of proving that company had notice of the assignment held to rest on the transferee of the shares).

Cf. *Prince Investment Co. v. St. Paul, etc. Land Co.*, 68 Minn. 121; 70 N. W. 1079; *Birmingham Trust, etc. Co. v. Louisiana Nat. Bank*, 99 Ala. 379; 13 So. 112; 20 L. R. A. 600; *Hotchkiss, etc. Co. v. Union Nat. Bank*, 68 Fed. 76; 15 C. C. A. 264.

⁴ But see *Wetherell v. Thirty-first Street, etc. Ass'n*, 153 Ill. 361; 39 N. E. 143 (where the purchaser was secretary of the company and as such charged with the duty of registering transfers).

⁵ *Boyd v. Redd*, 120 N. Car. 335; 27 S. E. 35; 58 Am. St. Rep. 792.

Cf. *Bank of Kentucky v. Bonnie Bros.*, 102 Ky. 343; 43 S. W. 407; *White's Bank v. Toledo Ins. Co.*, 12 Oh. St. 601.

But see *Grant v. Mechanics Bank*,

shareholder before he acquired his shares are within the lien.¹ Of course, the lien cannot be restricted by implication to debts due by the shareholder *qua* shareholder.² A debt owing by a partnership of which the shareholder is a member is within the lien,³ and so is a claim against the shareholder as surety.⁴ A statute creating a lien in favor of the company has been held to apply to debts contracted prior to the enactment.⁵

§ 961. **Enforcement of Lien.** — The company's lien, like any other equitable charge, may be enforced by a foreclosure suit.⁶ Where the debtor has assigned the shares subject to the lien by endorsement of the certificate, a decree of foreclosure may be entered in a suit between the company and the assignee although the assignor, who remains the registered holder, is not a party.⁷ But it has been held in Pennsylvania that the company cannot take the law into its own hands and sell the shares covered by the lien.⁸

§ 962. **Regulations giving Company a Right of Pre-emption.** — Provisions are sometimes found requiring a shareholder before selling his shares to offer them to the company at the price which he is able to obtain from an outsider. Such regulations

15 S. & R. (Pa.) 140; *Union Bank v. Laird*, 2 Wheat. 390 (where this point was not raised by counsel or noticed specifically by the court); *Rogers v. Huntingdon Bank*, 12 Serg. & R. (Pa.) 77.

¹ *Schmidt v. Hennepin County Barrel Co.*, 35 Minn. 511; 29 N. W. 200.

² *Mobile Mutual Ins. Co. v. Cul-lom*, 49 Ala. 558; *Rogers v. Huntingdon Bank*, 12 Serg. & R. (Pa.) 77. See also *Ex parte Stringer*, 9 Q. B. D. 436. Cf. *supra*, § 954.

³ *Arnold v. Suffolk Bank*, 27 Barb. (N. Y.) 424, 430; *Citizens' Bank v. Kalamazoo Co. Bank*, 111 Mich. 313; 69 N. W. 663; *Cunningham v. Ala. Life Ins. Co.*, 4 Ala. 652 (headnote inadequate); *Mechanics Bank v. Earp*, 4 Rawle (Pa.) 384.

⁴ *St. Louis, etc. Ins. Co. v. Good-fellow*, 9 Mo. 149.

⁵ *Birmingham Trust, etc. Co. v. East Lake Land Co.*, 101 Ala. 304; 13 So. 72; *First Nat. Bank v. Hartford, etc. Ins. Co.*, 45 Conn. 22.

⁶ *Mechanics Bldg., etc. Ass'n v. King*, 83 Cal. 440 (headnote inadequate); 23 Pac. 376.

But see *Aldine Mfg. Co. v. Phillips*, 118 Mich. 162; 76 N. W. 371; 74 Am. St. Rep. 380; 42 L. R. A. 531.

Cf. *Reese v. Bank of Commerce*, 14 Md. 271, 284; 74 Am. Dec. 536; *Farmers' Bank of Maryland's Case*, 2 Bland (Md.) 394.

⁷ *Citizens' Bank v. Kalamazoo Co. Bank*, 111 Mich. 313; 69 N. W. 663.

⁸ *Tete v. Farmers', etc. Bank*, 4 Brewst. (Pa.) 308.

should be held void as contemplating a reduction of capital, unless clearly authorized by statute. A provision of that sort has been held to have no application to a sheriff's sale under an execution against the shareholder;¹ but on the other hand, it has been held to apply to a transfer to a principal from an agent in whose name shares belonging to the principal have been registered.² A provision of this kind is not satisfied by offering to the company a larger number of shares than the outside purchaser offers to take.³ If the company registers a transfer, non-compliance with any such provision giving to the corporation a right of pre-emption is waived.⁴

§ 963. **Rescission of Transfer of Shares for Fraud of Transferor.** — A transfer of shares, like any other conveyance of property, may be set aside at the instance of the transferee if he was induced to accept the shares by the fraud of the transferor. Where the transfer has been completed a bill in equity to cancel it may be maintained by the transferee against the transferor and the company.⁵ But if the company was not party to the fraud, it would seem clear on principle that the defrauded transferee should be subject to a shareholder's liabilities to the company, and its creditors, during such time as the shares stand in his name, and that his only relief against such liabilities would be by holding the transferor responsible by way of indemnity.⁶

§ 964-§ 975. *Contracts for Sale or Transfer of Shares.*

§ 964. **In general.** — Contracts for the sale or transfer of shares differ in some respects from ordinary contracts for sale of personal property. As shown above, the complete legal title does not pass immediately upon the making of the contract, as is usually the case in contracts of sale of chattels.

¹ *Barrows v. Nat. Rubber Co.*, 12 R. I. 173.

² *Barrett v. King*, 63 N. E. 934; 181 Mass. 476.

³ *Sweetland v. Quidnick Co.*, 11 R. I. 328.

⁴ *Am. Nat. Bank v. Oriental Mills*, 17 R. I. 551; 23 Atl. 795.

⁵ *Farwell v. Colonial Trust Co.*, 147 Fed. 480; 78 C. C. A. 22.

But see *Behlow v. Fischer*, 102 Cal. 208, 214; 36 Pac. 509 (declaring that the corporation is not a proper party to such a bill).

⁶ But see *Stufflebeam v. DeLashmutt*, 101 Fed. 367.

§ 965. **Whether Contract is Joint or Several on Part of Vendors.** — Where a contract is made for the sale of all the shares of a corporation, as is often done in pursuance of schemes of consolidation, amalgamation, and reorganization, there is sometimes a question whether the contract should be construed as a several sale by each shareholder of the shares held by him or whether it should be construed as a sale by the corporation of its entire property and assets. Where in such a case the purchaser buys at so much a share, and there is no provision that the proceeds shall become a joint fund, the contract is several on the part of each shareholder, and each may therefore maintain a separate action against the purchaser.¹

§ 966. **Whether Non-disclosure of Contracts for Sale of Shares is a Fraud upon other Persons interested in the Company.** — Inasmuch as shares are freely transferable, an agreement made between a promoter and a subscriber to shares, whereby the former agrees to purchase from the latter the shares subscribed by him, if the undertaking should prove unsuccessful, is quite valid even though the existence of the agreement be kept secret so that the public may be induced to believe that the subscriber in question — perhaps a capitalist of repute — had shown faith in the company by actually risking his money in its shares.² Inasmuch as shares are freely transferable, no one is justified in concluding that a shareholder has made no contract whereby he is guaranteed against loss from depreciation of his shares.

§ 967. **Description of the Shares to be Transferred.** — The number and character of the shares contracted to be transferred ought to be and usually are specified in the contract.³ A contract which calls for “£1000 worth of fully paid-up shares,” has been held to mean shares of that actual value in

¹ *Dowling v. Wheeler*, 117 Mo. App. 169; 93 S. W. 924.

² *Morgan v. Struthers*, 131 U. S. 246; 9 Sup. Ct. 726; *Meyer v. Blair*, 109 N. Y. 600; 17 N. E. 228; 4 Am. St. Rep. 500.

³ As to an English statute requiring contracts for sale of bank shares to specify the denoting numbers of the shares, see *infra*, § 969. As to whether the right of a vendor under a contract to transfer or cause

to be transferred all the stock of a corporation is subject to a condition precedent that he be able to deliver the entire amount of stock, see *Alden Speare's Sons Co. v. Casein Co.*, 106 N. Y. Supp. 980 (where a provision that the vendor should cause the transfer of shares owned by a third person was held a mere collateral stipulation and not a condition).

the market and not shares of that nominal or par value.¹ Inasmuch as all shares in a corporation *prima facie* stand on an equality, a contract calling for the transfer of shares in a company to be subsequently incorporated means shares which shall stand on an equality with all other shares in the same company, and therefore is not satisfied by a transfer of ordinary or deferred shares in a company which has issued preferred shares.²

§ 968. **Statute of Frauds.** — In England, contracts for sale of shares are held not to be contracts for sale of goods, wares, and merchandise within the seventeenth section of the Statute of Frauds.³ In the United States, a conflict of authority exists on this point.⁴ Where contracts for sale of shares are held to be within the statute, a transfer of the shares or some of them to the vendee and the issue of a certificate for them to him constitute such delivery and acceptance as will take the contract out of the statute.⁵

§ 969. **Sales on the Stock Exchange — Usages of Brokers.** — Contracts for sale of shares in large corporations whose securities are listed are usually made through brokers upon the stock exchange.⁶ Such contracts in their interpretation and operation are governed by the rules and customs of the stock exchange upon which they are made.⁷ By these rules and customs even public statutes are sometimes brushed aside or evaded.

For example, a British statute known as Leeman's act,⁸ provides that every contract for sale of bank shares shall be void unless it designates in writing the distinguishing numbers of the shares in the register of the company, if there are such distinguishing numbers. Nevertheless, the London stock exchange

¹ *McIlquham v. Taylor* (1895), 1 Ch. 53.

² *McIlquham v. Taylor* (1895), 1 Ch. 53 (per Stirling, J.).

³ *Supra*, § 505.

⁴ *Ibid.*

⁵ *Dinkler v. Baer*, 92 Ga. 432; 17 S. E. 953. As to what is sufficient to take the contract out of the statute, see further 2 Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., 892 et seq.

⁶ Cf. *Nickalls v. Merry*, L. R. 7 H. L. 530. As to privity between principals in respect of contracts

entered into on the London Stock Exchange, see *Levitt v. Hamblet* (1901), 2 K. B. 53; *Beckhanson & Gibbs v. Hamblet* (1901), 2 K. B. 73; *Scott & Horton v. Godfrey* (1901), 2 K. B. 726.

⁷ *Stray v. Russell*, 1 E. & E. 888; *London Founders' Ass'n v. Clarke*, 20 Q. B. D. 576. Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., Chap. IV, pp. 410-474 (where a full citation and discussion of the authorities will be found).

⁸ 30 Vict., c. 29.

frequently disregards the provisions of this act. Indeed, one can readily perceive the inconvenience that would result from a uniform compliance with the statute. Consequently, the courts have held that a person who with knowledge of this usage of the stock exchange employs a broker to buy or sell shares for him impliedly consents that the contract of sale shall be made in accordance with the custom of the stock exchange instead of in accordance with the provisions of the statute; and hence, if the contract is made accordingly, and if the broker, being by the rules of the stock exchange bound to perform the agreement under penalty of expulsion from the exchange, does perform it, he may sue his customer and recover indemnification for any losses sustained in performing the agreement.¹ To that extent, the custom of the stock exchange is permitted to override the policy of the statute; but the courts could not well be expected to go any further in sustaining the brokers' usage in opposition to the statute. For instance, unless the customer had actual knowledge of the usage, the broker would not be permitted, as in the case just stated, to perform the legally invalid agreement at the customer's expense.² So, where a person commissions a broker to sell shares without cognizance of or reference to the custom, the broker impliedly agrees to make a legally binding contract; and if the contract which he makes does not comply with the act of parliament and is repudiated on that ground, he must make good the loss which results to his principal.³ If a transfer made in pursuance of a contract which does not comply with the act of parliament is accepted by the transferee or by his broker on his behalf, the transferor may require the transferee to indemnify him against any further liability as shareholder;⁴ but this result is reached not because of the custom of the brokers to disregard the act, but because the acceptance of the transfer makes the transferor trustee for the transferee and vests in the latter an equitable title to the shares, so that the void executory contract is performed and the act of parliament no longer applies.

§ 970. **When Purchase Money is payable.** — Where a contract for sale of shares is made without any extraordinary or unusual

¹ *Seymour v. Bridge*, 14 Q. B. D. 460.

² *Neilson v. James*, 9 Q. B. D. 546.

⁴ *Loring v. Davis*, 32 Ch. D. 625.

³ *Perry v. Barnet*, 15 Q. B. D. 388.

terms, whether on the stock exchange or otherwise, the purchase money is payable on delivery or tender of the share-certificate coupled with a transfer in regular form;¹ although a valid transfer on the books of the company without the delivery of any certificate would amount to performance of the contract.² If no certificate has been issued to the transferor, a tender of a deed of assignment is sufficient.³ A tender of certificates made out in the name of a third person without any endorsement by or transfer from him, is of course not a sufficient tender of performance by a vendor of shares.⁴ The purchase money may be payable, although the vendor retains the certificate in his possession by way of security for payment of the price: thus, where the selling broker deposited the certificates duly endorsed with a trust company by whom they were to be delivered out only on the joint order of the buying and selling brokers, the court held that the transaction amounted to a transfer of the title subject to the vendor's right to require the trust company to obtain the purchase money before surrendering the certificate, and that accordingly an action for the purchase price might be maintained by the vendor.⁵

§ 971. **Burden of procuring Registration of Transfer on Transferee.**—The burden of procuring registration of the transfer does not rest upon the transferor.⁶ Hence, where the company has the right to reject any transferee, the purchase money cannot be recovered back by a transferee who is rejected:⁷ he undertook the burden of procuring registration, and the transferor consequently cannot be deemed impliedly to have contracted

¹ *London Founders' Ass'n v. Clarke*, 20 Q. B. D. 576; *Noyes v. Spaulding*, 27 Vt. 420. influenced by the peculiar terms of an Oklahoma statute).

² *McGue v. Rommell* (Cal.), 83

Cf. *Brown v. Smith*, 122 Mass. Pac. 1000.

589; *Bruce v. Smith*, 44 Ind. 1

(where the delivery of the endorsed

certificate was admitted by de-

murrer to have been accepted as

full performance).

³ *White v. Salisbury*, 33 Mo. 150.

See supra, § 853.

Cf. *Boatmen's Ins. & Trust Co. Co.*,

v. Able, 48 Mo. 136; *Dinkler v. Baer*,

92 Ga. 432; 17 S. E. 953.

But see *Haynes v. Brown* (Okl.), *London Founders' Ass'n v. Clarke*, 89 Pac. 1124 (where the decision was

⁴ *Nicolls v. Reid*, 109 Cal. 630;

42 Pac. 298.

⁵ *Frazier v. Simmons*, 139 Mass.

531; 2 N. E. 112.

⁶ *Skinner v. City of London*

Marine Ins. Corp., 14 Q. B. D. 882.

Cf. *Newberry v. Detroit, etc. Iron*

Co., 17 Mich. 141; *Webster v. Upton*,

91 U. S. 65, 71-72.

⁷ *Stray v. Russell*, 1 E. & E. 888;

that the transferee should be accepted as a shareholder. Nor can the money be recovered back on the ground of total failure of consideration, for the transferee still has the certificates, which are of some value even though the company refuses to recognize him as a shareholder, so that the failure of consideration is at most partial merely. It is sometimes said that "it is the duty of the transferor to see that his transfer is registered";¹ but this dictum means merely that if he wishes to escape further liability as shareholder he must see to the registration of the transfer, and should not be construed as conflicting with the rule that as between transferor and transferee the duty of procuring registration rests on the latter.

§ 972. **Obligation of Purchaser to indemnify Vendor against Liability as Shareholder.** — The procurement of registration of the transfer being within the province of the transferee, the transferor is entitled to be indemnified by the transferee for any liability he may sustain as shareholder in consequence of a delay in registering the transfer.² The statute of limitations does not begin to run against such a claim for indemnity until the transferor is actually compelled to pay, even though a reasonable time for registration of the transfer has elapsed after the delivery of the certificate.³ An action by a transferor against

¹ *Tucker v. Mulligan*, 28 Vict. L. R. 1, 6; *Heights of Maribyrnong Estate Co.*, 22 Vict. L. R. 438, 445.

² *Paine v. Hutchinson*, 3 Ch. 388; *Loring v. Davis*, 32 Ch. D. 625; *Nickalls v. Merry*, L. R. 7 H. L. 530; *Bowring v. Shepherd*, L. R. 6 Q. B. 309; *Hawkins v. Maltby*, 4 Ch. 200; *Hutzler v. Lord*, 64 Md. 534; 3 Atl. 891; *Brinkley v. Hambleton*, 67 Md. 169, 178 (semble); 8 Atl. 904; *Kellogg v. Stockwell*, 75 Ill. 68; *Wynne v. Price*, 3 De G. & S. 310; *Johnson v. Underhill*, 52 N. Y. 203; *Gordon v. Parker*, 10 La. 56 (head-note inadequate); *Gustard's Case*, 8 Eq. 438 (semble); *People's Home Sav. Bank v. Stadtmuller* (Cal.), 88 Pac. 280, 281-282 (semble); *Shepherd v. Gillespie*, 3 Ch. 764 (where a transferee who had not authorized the transfer was estopped from denying his acceptance by retaining the transfer in his possession); *Man v. Boykin* (S. Car.), 60 S. E. 17.

But see *Sayles v. Blane*, 14 Q. B. 205; *Treadway v. Johnson*, 33 Mo. App. 122 (decision based on peculiar terms of contract); *Humble v. Langston*, 7 M. & W. 517.

Cf. *Ex parte Head*, 15 L. T. 262; *Davis v. Haycock*, L. R. 4 Ex. 373. In *Walker v. Bartlett*, 18 C. B. 845, it was said that the purchaser was under no obligation to have himself registered as shareholder, but was bound only to indemnify the vendor in case he exercised his right not to present the transfer for registration. Cf. *McClure v. Central Trust Co.*, 28 N. Y. App. Div. 433, 441; 53 N. Y. Supp. 188. *Sed quære.*

³ *Hutzler v. Lord*, 64 Md. 534; 3 Atl. 891.

a transferee for indemnity may clearly be maintained notwithstanding the fact that the company is in liquidation:¹ the question is entirely collateral to the liabilities to be adjusted in the winding-up proceedings. If the nominal transferee is an infant, so that the registration of the transfer does not relieve the transferor from liability as a shareholder, the transferor may demand indemnity from a person for whom the infant was acting as trustee.² The transferee is also bound to indemnify the transferor against any statutory liability as a past member which the latter may have been compelled to discharge.³

If the nominal transferee is a mere nominee or bare trustee of another, the transferor may require indemnity from the *cestui que trust* as well as the trustee.⁴ But an arrangement between the transferor and the nominal transferee whereby the purchase money is returned and the transfer cancelled will bar any such claim against the *cestui que trust*.⁵

If the transferee has in turn assigned the shares before the original transferor is called upon to pay, the latter may proceed against the ultimate purchaser. According to an English case, he may also, if he choose, proceed against his own immediate transferee;⁶ but a Maryland decision is diametrically opposite on this point.⁷ If the only basis for the claim of indemnity is a quasi-contractual obligation springing out of the principle *qui sentit commodum sentire debet et onus*, then the reasoning of the Maryland court is irresistible. If, on the other hand, it is an implied term of every contract for sale of shares that the purchaser shall reimburse the vendor against any further liability as shareholder, then it would seem that the purchaser should not be able to avoid this obligation by assigning the shares.

§ 973. **Implied Warranties by Vendor.**—The vendor impliedly warrants the genuineness of the certificate⁸ and of the

¹ *Joseph v. Holroyd*, 22 W. R. 614.

² *Brown v. Black*, 8 Ch. 939.

³ *Kellock v. Enthoven*, L. R. 9 Q. B. 241; *Roberts v. Crowe*, L. R. 7 C. P. 629 (holding that a compromise of the liquidator's claim against the transferee does not protect the latter from his obligation to reimburse the transferor from liability as a past member).

⁴ *Castellan v. Hobson*, 10 Eq. 47.

⁵ *Maynard v. Eaton*, 9 Ch. 414 (where the nominal transferee being an infant had sued the transferor for damages for fraud).

⁶ *Kellock v. Enthoven*, L. R. 9 Q. B. 241.

⁷ *Brinkley v. Hambleton*, 67 Md. 169; 8 Atl. 904.

⁸ *Fifth Ave. Bank v. Forty-second St., etc. R. R. Co.*, 137 N. Y.

transfer.¹ If the transferor endorses the certificate in blank, he warrants the genuineness of the certificate not merely in favor of the immediate transferee but also in favor of any one who in due course acquires the certificate and who according to accepted principles of law would, if the certificate were genuine, have the right to insert his own name in the blank and become registered as shareholder, even though the immediate transferee was aware of the spuriousness of the certificate and therefore could not have claimed any benefit from the warranty.² On the other hand, it has been held that the vendor does not warrant the corporate existence — at any rate, not the *de jure* corporate existence — of the company which issued the shares;³ but in England, where the doctrine of *de facto* corporations is not recognized,⁴ it seems that the vendor is held impliedly to warrant the legal existence of the company.⁵ In New York, it has been held that the vendor impliedly warrants the shares to be free of liens or encumbrances in favor of the company;⁶ but this decision would probably not be universally followed. For instance, where a share-certificate with a transfer duly endorsed thereon is delivered and accepted in performance of a contract of sale, there is, at least according to a Pennsylvania case, no implied warranty that the shares represented by the certificate are legally issued, so that if it subsequently transpires that the shares in question were part of an illegal overissue, the purchaser cannot rescind the contract and recover back the purchase money.⁷

231, 238; 33 N. E. 378; 33 Am. St. Rep. 712; 19 L. R. A. 331 (semble). 703, affirmed, 148 N. Y. 652; 43 N. E. 68; 31 L. R. A. 776; 51 Am.

Cf. *Wood v. Sheldon*, 42 N. J. St. Rep. 727 (based upon a rule of Law 421; 36 Am. Rep. 523; *Jarvis* the stock exchange).

v. Manhattan Beach Co., 53 Hun Bank, 16 Fed. Cas. 1113.
(N. Y.) 362; 6 N. Y. Supp. 703, affirmed, 148 N. Y. 652; 43 N. E. 68; ² *Matthews v. Massachusetts Nat. Bank*, 16 Fed. Cas. 1113.
31 L. R. A. 776; 51 Am. St. Rep. 727 ³ *Marshall v. Keach* (Ill.), 81 N. E. 29; *Harter v. Eltzroth*, 111 Ind. 159; 12 N. E. 129; *Burwash v. Ballou* (Ill.), 82 N. E. 355.
(based upon a rule of the stock exchange).

As to whether the vendor warrants the shares to be full-paid as stated in the certificate, see *Higgins v. Illinois Trust, etc. Bank*, 193 Ill. 394; 61 N. E. 1024; *Foot v. Illinois Trust, etc. Bank*, 194 Ill. 600; 62 N. E. 834. ⁴ See *supra*, § 284.
⁵ *Kempson v. Saunders*, 4 Bing. 5.
⁶ *McClure v. Central Trust Co.*, 165 N. Y. 108; 58 N. E. 777; 53 L. R. A. 153.

⁷ *People's Bank v. Kurtz*, 99 Pa. St. 344; 44 Am. Rep. 112.
¹ *Jarvis v. Manhattan Beach Co.*, 53 Hun (N. Y.) 362; 6 N. Y. Supp. Contra: *Lincoln v. New Orleans*

§ 974. **Purchase on Margin.** — Purchases of shares on margin, a familiar feature of dealing in stocks at the present day, have few or no legal peculiarities pertinent to the present subject. According to the weight of authority, such a purchase amounts in legal effect to a purchase coupled with an hypothecation of the purchased shares with the purchaser's broker to secure payment of the portion of the purchase money advanced by the broker.¹ The purchaser's broker is not bound to keep the purchased shares separate from other shares standing in his name, but does his full duty if he is always ready to transfer an equal number of shares of the same issue.²

§ 975. **Specific Performance of Contracts for Sale or Transfer of Shares.** — Although courts of equity will not ordinarily grant specific performance of contracts for sale of personal property, and although in an early case specific performance was refused of a contract for sale of South Sea stock,³ yet in modern times in England the rule has been established that equity will grant specific performance of contracts to sell or transfer shares in railway and other companies.⁴ The reason assigned by the courts for this conclusion was that shares in railway companies, for example, were limited in number and could not always be procured in the market, like consols or public stocks.⁵ This reason is hardly applicable to shares in the large railway and industrial companies of the present time which can always be purchased on the stock exchange. Perhaps sounder reasons for granting specific performance are the rapid fluctuation of value to which shares in many corporations are liable and which renders pecuniary damages an uncertain and therefore inade-

Express Co., 45 La. Ann. 729; 12 So. 937 (where the plaintiff acquired the shares from the company itself). Cf. *supra*, § 579-§ 582.

Cf. *Wood v. Sheldon*, 42 N. J. Law 421; 37 Am. Rep. 523.

¹ 1 Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., 179-200. But as to a peculiarity of Massachusetts law, see *Re Swift*, 105 Fed. 493, affirmed 112 Fed. 319. A large portion of the law of stock brokers and their dealings relates to these transactions, and Mr. Dos Passos' valuable book is largely

taken up with a discussion of the various questions involved, which, however, hardly relate to corporation law, properly so called.

² *Worthington v. Tormey*, 34 Md. 182. See also *supra*, § 500, and cases there cited.

³ *Cud v. Rutter*, 1 P. Wms. 570.

⁴ *Duncuft v. Albrecht*, 12 Sim. 189; *Poole v. Middleton*, 29 Beav. 646; *Cheale v. Kenward*, 3 De G. & J. 27; *Paine v. Hutchinson*, 3 Ch. 388; *Wynne v. Price*, 3 De G. & S. 310.

⁵ *Duncuft v. Albrecht*, 12 Sim. 189.

quate form of relief, and also the fact that shares are often purchased for the purpose of obtaining control of the corporation, in which case the damages would be difficult to estimate fairly.

Accordingly, in the United States, specific performance of a contract for sale of shares will be granted when the uncertain value of the shares renders it difficult to do justice by an award of damages,¹ or where the shares agreed to be sold constitute a controlling interest in the company;² but unless some such special ground for equitable interference exists the parties will according to many authorities be left to the remedy at law.³ It should be observed, however, that the American authorities supporting this latter proposition rest upon the early English

¹ *White v. Schuyler*, 1 Abb. Pr., n. s. (N. Y.), 300; *Treasurer v. Commercial Mining Co.*, 23 Cal. 390 (mining stock); *Manton v. Ray*, 18 R. I. 672; 29 Atl. 998; 49 Am. St. Rep. 811 (where the bill alleged and a demurrer admitted that plaintiff could not obtain the stock elsewhere); *Newton v. Wooley*, 105 Fed. 541; *Dennison v. Keasbey* (Mo.), 98 S. W. 546 (where none of the stock was procurable in the market); *Rau v. Seidenberg*, 104 N. Y. Supp. 798; 53 N. Y. Misc. 386; *Baumhoff v. St. Louis, etc. R. R. Co.* (Mo.), 104 S. W. 5.

But see *Clements v. Sherwood-Dunn*, 95 N. Y. Supp. 766; 108 N. Y. App. Div. 327.

Cf. *Fleishman v. Woods*, 135 Cal. 256; 67 Pac. 276; *Currie v. Jones*, 138 N. Car. 189; 50 S. E. 560; *Eichbaum v. Sample* (Pa.), 62 Atl. 837; 213 Pa. 216.

² *O'Neill v. Webb*, 78 Mo. App. 1; *Northern Central Ry. Co. v. Walworth*, 193 Pa. St. 207; 44 Atl. 253; 74 Am. St. Rep. 683. Cf. *Hower v. Weiss, etc. Co.*, 55 Fed. 356; 5 C. C. A. 129; *Butler v. Murphy*, 80 S. W. 337 (Mo.); *Scruggs v. Cotterill*, 67 N. Y. App. Div. 583; 73 N. Y. Supp. 882.

But see *Ryan v. McLane*, 91 Md. 175; 46 Atl. 340; 80 Am. St. Rep. 438; 50 L. R. A. 501 (where the

contract was regarded as one to which a court of conscience ought not to lend its aid); *Clements v. Sherwood-Dunn*, 95 N. Y. Supp. 766; 108 N. Y. App. Div. 327.

³ *Treasurer v. Commercial Mining Co.*, 23 Cal. 390 (semble); *Goodwin Gas Stove, etc. Co.'s Appeal*, 117 Pa. St. 514; 12 Atl. 736; 2 Am. St. Rep. 696; *Avery v. Ryan*, 74 Wisc. 591; 43 N. W. 317; *Rigg v. Reading, etc. Ry. Co.*, 191 Pa. St. 298; 43 Atl. 212; *Kennedy v. Thompson*, 97 N. Y. App. Div. 296; 89 N. Y. Supp. 963; *Bateman v. Straus*, 86 N. Y. App. Div. 540; 83 N. Y. Supp. 785.

Cf. *Noyes v. Marsh*, 123 Mass. 286; *Todd v. Taft*, 7 Allen (Mass.) 371; *Leach v. Forbes*, 11 Gray (Mass.) 506; 71 Am. Dec. 732 (specific performance decreed of a contract to transfer both land and shares of capital stock); *Johnson v. Stratton*, 109 Ill. App. 481; *Watkins v. Robertson* (Va.), 54 S. E. 33 (where specific performance was allowed without noticing this objection); *Boggs v. Boggs & Buhl* (Pa.), 66 Atl. 105. The most elaborate discussion of the question on principle and in the light of the conflicting authorities to be found in the books is contained in 2 Dos Passos on Stock Brokers and Stock Exchanges, 2d ed., 810-848.

cases which refused specific performance of contracts for sale of "public stocks," whereas the "public stocks" in question were not capital stocks at all but were government obligations. The English cases, as stated above, grant specific performance of contracts for sale of shares in corporations — in other words, shares of capital stock — even in the case of railway corporations and other companies whose securities are dealt in on the stock exchange.

A suit for specific performance of a contract for sale of shares must be distinguished from a suit by a transferee of shares to compel the company to register a transfer already executed by the vendor.¹ Moreover, an executory contract to sell shares should be distinguished from an executed sale, the legal title being retained by the vendor as security for the purchase money.² Such a transaction is equivalent to a formal transfer followed by a mortgage back to secure the purchase money, and in all such cases the vendee has a remedy by a bill to redeem.

Wherever specific performance of a contract to sell shares is allowed, the remedy as in other cases of specific performance is mutual,³ and will be granted either at the suit of the transferor⁴ or the transferee.⁵ The assumption of the liabilities of a shareholder by the transferee is sufficient consideration for the transferor's promise.⁶

The court will not refuse to decree specific performance where the directors of the company have a right to prescribe the mode of transfer, but will compel the vendor to do all he can to perfect the transfer.⁷ The decree may pass even though the company has gone into liquidation; and the transferee may be required to indemnify the transferor against any liability as shareholder in the liquidation proceedings.⁸

¹ See *supra*, § 934. *Mechanics Bank v. Seton*, 1 Pet. 299, 305; *Lucas v. Milliken*, 139 Fed. 816, 822-826 (holding that the company is not a necessary party to a bill for specific performance of a contract for the sale of some of its shares); *Scherck v. Montgomery*, 33 So. 507; 81 Miss. 426; *Thornton v. Martin*, 116 Ga. 115, 118; 42 S. E. 348.

² *Beardsley v. Beardsley*, 138 U. S. 262; 11 Sup. Ct. 318.

³ But see *Eckstein v. Downing*, 64 N. H. 248; 9 Atl. 626; 10 Am. St. Rep. 404.

⁴ *Paine v. Hutchinson*, 3 Ch. 388; *Cheale v. Kenward*, 3 De G. & J. 27. Cf. *Ex parte Head*, 15 L. T. 262.

⁵ *Duncuft v. Albrecht*, 12 Sim. 189, *Poole v. Middleton*, 29 Beav. 646.

⁶ *Cheale v. Kenward*, 3 De G. & J. 27.

⁷ *Poole v. Middleton*, 29 Beav.

⁸ *Paine v. Hutchinson*, 3 Ch. 388.

§ 976-§ 984. TRANSMISSION OF SHARES.

§ 976-§ 981. *Death of Shareholder.*

§ 976. In general — Rights and Liabilities of Executor or Administrator before Entry of Decedent's Death in the Company's Register — Mutual Rights of specific and residuary Legatees. — The subject of transmission or change in the ownership of shares otherwise than by transfer next demands attention; and we shall first consider the transmission or devolution of shares upon the death of the owner.¹ For certain purposes, the shares vest in the executor or administrator immediately upon the death of the decedent, or grant of letters, without the necessity for any entry upon the company's register and while the shares still stand in the name of the deceased.² Thus, the executors are entitled, while the shares remain in their testator's name, to receive any dividends payable thereon, and probably, in the absence of any by-law or regulation to the contrary, to vote in respect of the shares.³ So, also, the executors may participate *pari passu* with the registered shareholders in any increase of capital offered for subscription to the existing members of the company.⁴ The executors, moreover, may execute a transfer of the shares which will pass a good title to the transferee and entitle him to be registered as shareholder.⁵

Furthermore the executors are liable in their representative capacity for calls upon the shares made after the testator's death and before any sale or distribution of the shares;⁶ but unless the executors are registered as shareholders, they are not liable personally.⁷ The estate of a deceased shareholder in whose name the shares continue to stand on the company's

¹ The fullest consideration of original shares; *Jacques v. Chambers*, 4 Eng. Ry. & Canal Cas. 205.
 in 1 Lindley on Companies (6th ed., p. 731 et seq.) Bk. III, Chap. 7.

² As to the right to inspect books of the corporation, see *infra*, § 1107.
³ See *infra*, § 1227. Cf. *Dana v. American Tobacco Co.* (N. J.), 65 Atl. 730, affirmed, 69 Atl. 223.

⁴ *Supra*, § 605. Shares acquired by the executors in exercise of this right go to a specific legatee of the

⁵ *Colonial Bank v. Cady*, 15 A. C. 267. See *infra*, § 980, § 981.

⁶ *James v. Buena Ventura Nitrate Co.* (1896), 1 Ch. 456 (semble). See also *supra*, § 768. Cf. *Matteson v. Dent*, 176 U. S. 521; 20 Sup. Ct. 419; *Lanigan v. North*, 69 Ark. 62; 63 S. W. 62.

⁷ *Buchan's Case*, 4 A. C. 549.

books is liable for calls made after the decedent's death, even though the company's regulations provide that an executor or administrator shall not be a shareholder nor entitled to the rights of a shareholder.¹ In the absence of a direction to the contrary, calls made after a testator's death upon shares bequeathed specifically should as between the specific legatee and the residuary legatee be paid by the former;² but if payment of the calls be necessary to constitute the testator a complete shareholder the rule is different.³ If the will contain a direction that debts shall be paid out of the real estate, calls made after the testator's death must be borne by the realty to the exoneration of the personal estate.⁴ Any liability of the decedent's estate is terminated when the shares are transferred to or devolve upon the legatee or distributee.⁵ Of course, executors are liable for any calls made in the lifetime of the testator to the same extent as for any other debt of the deceased.⁶

Sometimes, the rights of executors or administrators of a deceased shareholder who have not been registered in his place, to receive dividends on the shares, to vote in respect thereof, and to transfer the same, are taken away or abridged by statute.⁷

§ 977. **Registration of Executor or Administrator as Shareholder.** — In order that the registration of an executor as shareholder should have any effect, it must be accomplished by his authority. The mere production of papers to prove the executor's title will not authorize the company to substitute his name for that of the testator in the register of shareholders.⁸

¹ *Houldsworth v. Evans*, L. R. 3 H. L. 263; *Baird's Case*, 5 Ch. 725.

² *Day v. Day*, 1 Dr. & Sm. 261; *Armstrong v. Burnet*, 20 Beav. 424; *Addams v. Ferick*, 26 Beav. 384 (where the call although determined upon before the testator's death was not deemed to be made until afterwards); *Re Box*, 1 Hem. & Mill. 552, 555 (semble).

See 1 Lindley on Companies, 6th ed., 739-740. As to laying by a reserve fund to meet future calls which ought to be borne by the general estate, see *Jacques v. Chambers*, 4 Eng. Ry. & Can. Cas. 499; *Wentworth v. Chevill*, 3 Jur., n. s., 805.

As to the case where the shares are bequeathed to one for life with remainder over, see *infra*, § 1110.

³ *Day v. Day*, 1 Dr. & Sm. 261 (semble); *Armstrong v. Burnet*, 20 Beav. 424 (semble).

⁴ *Blount v. Hipkins*, 7 Sim. 51 (where the testator had expressly covenanted to pay the calls).

⁵ See *infra*, § 979.

⁶ *Houldsworth v. Evans*, L. R. 3 H. L. 263.

⁷ *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77 (applying the Companies Clauses Act).

⁸ *Buchan's Case*, 4 A. C. 549. Cf. *Dana v. American Tobacco Co.*

The ordinary and regular method of putting the shares into the name of the executor is as follows: the executor signs a transfer in the ordinary form to himself as executor; this transfer together with the testator's share-certificate and a certificate from the proper court of the grant of letters is presented to the company, and the appropriate entries are thereupon made.¹ The registration of an executor as shareholder in the room of his testator is not the registration of a transfer within the meaning of regulations authorizing the company to decline to register a transfer by a shareholder who is indebted to it or requiring all transfers to be executed by the transferor and the transferee.² The registration of an executor in his capacity of executor in respect of shares owned by the testator — an entirely proper proceeding — should be distinguished from a registration of the shares in the name of the executor individually, which may amount to a devastavit or tortious conversion of the shares on his part.³

§ 978. **Rights and Liabilities of Executor or Administrator after Registration as Shareholder.** — If the executors of a deceased shareholder have the shares registered in their own name, though as executors, they become virtually trustees. For instance, they become liable personally for any calls made while the shares stand in their names.⁴ So, one of two co-executors whose names are entered upon the register of shareholders as such has no more power to transfer the shares without the concurrence of his fellow than one of two co-owners not executors would have, notwithstanding the common law rule that one of two co-executors may transfer any part of the estate without the concurrence of his colleague.⁵

§ 979. **Devolution of Title from Executor to Legatee.** — It would seem that a transfer from an executor to a legatee should

(N. J.), 65 Atl. 730 (letter from *Bank v. Aronstein*, 117 Fed. 601, 606; administrator to company respecting 54 C. C. A. 663.

payment of dividends not sufficient to charge the corporation with the duty of registering him as shareholder or of taking notice of his address), affirmed, 69 Atl. 223. ² *Holland v. Ball* (Mass.), 78 N. E. 772.

⁴ *Buchan's Case*, 4 A. C. 549; *Leeds Banking Co.*, 1 Ch. 231.

⁵ *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77. *Quære*: Is this

A. C. 267. See *supra*, § 900, for decision applicable in America, or statement and criticism of this case. does it depend entirely upon the

² *London, Paris & American* peculiar terms of English statutes?

be governed by the same rules as any other transfer. Thus, where under the statutes or internal regulations by which the company is governed, the directors have power to decline to register a transfer to a person whom they disapprove, it has been held that they may refuse to register a transfer from the executor of a deceased shareholder to the residuary legatee.¹ To be sure, in an early Maryland case, it was held that the assent of an executor to a bequest of shares *ipso facto* vests the legal title in the legatee without the necessity of an entry on the books, just as in the case of an ordinary chattel;² but on principle and according to the authority of the Federal Supreme Court a legatee or distributee must be registered as shareholder before he can be deemed to be clothed with complete legal title.³ If a transfer is made to a distributee in pursuance of a decree of distribution which is reversed on appeal the title of the executor revives.⁴

§ 980. **Requisites of formal Transfer by Executors.** — A written transfer signed by an executor with his individual name merely will pass shares which he holds as executor.⁵ A transfer by one of several co-executors without the joinder of his colleague will pass shares owned by the decedent's estate, and the corporation is therefore under no liability for registering such a transfer.⁶

The effect of a transfer in blank by executors in raising an estoppel in favor of a transferee has been already considered.⁷

§ 981. **Sales of Shares by Executors.** — Inasmuch as executors and administrators have at common law full power to sell any assets of the decedent, the company will incur no liability for registering a transfer by an executor which is, or is reason-

¹ *South Yorkshire Wine Co.*, 8 840; *Baker v. Beach*, 85 Fed. 836; Times L. R. 413. *Burr v. Sherwood*, 3 Bradf. (N. Y.)

² *Farmers', etc. Bank v. Iglehart*, 85.

³ 6 Gill (Md.) 50.

⁴ *Ashton v. Zeila Mining Co.*, 134

Cf. *Cooper v. Illinois Central R. R. Co.*, 38 N. Y. App. Div. 22, 25-26; *Heggerty*, 130 Cal. 516.

57 N. Y. Supp. 925; *Jones v. Atchison, etc. R. R. Co.*, 150 Mass. App. Div. 601; 44 N. Y. Supp. 969. 304; 23 N. E. 43; 5 L. R. A. 538.

⁵ *Matteson v. Dent*, 176 U. S. 521, 530-532 (headnote inadequate); 20 Sup. Ct. 419; *People's Home Sav. Bank v. Stadtmuller* (Cal.), 88 Pac. 280.

⁶ *Lowry v. Commercial, etc. Bank*, Taney 310, 330 (semble). But cf. *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77 (stated supra, § 978).

⁷ Supra, § 900.

Cf. *Tourtelot v. Finke*, 87 Fed.

ably supposed to be, a *bona fide* sale for purposes of administration, even though the purchase money be afterwards misapplied or indeed even though the supposed sale be in fact fraudulent or colorable merely.¹ For this reason, when a transfer by an executor or administrator to a purchaser is presented for registration, the company cannot properly insist upon any evidence of the transferor's authority to make the transfer.² Moreover, although a statute prohibit an administrator from selling at private sale, the company incurs no liability for registering in good faith a transfer in pursuance of a private sale.³ An executor has of course no right to pledge the assets of the estate; and if he undertake to pledge shares belonging to the estate, the company may and should refuse to register a transfer to the pledgee or by the pledgee to any person cognizant of the facts.⁴

§ 982. **Marriage of Female Shareholder.** — The law of transmission of shares by the marriage of a female shareholder has been so generally altered by statute that it may now fairly be regarded as obsolete and interesting rather to antiquarians than to practising lawyers. Shares being personal property of the kind known as choses in action, the husband had the right to reduce them to possession, and thus make himself absolute owner.⁵

§ 983. **Bankruptcy of Shareholder.** — Upon the bankruptcy of

¹ *Wooten v. Wilmington, etc. R. Co.*, 38 S. E. Rep. 298 (semble); 128 N. C. 119; 56 L. R. A. 615; *Hutchins v. State Bank*, 12 Met. (Mass.) 421; *Cox v. First Nat. Bank*, 119 N. Car. 302; 26 S. E. 22; *Lowry v. Commercial, etc. Bank*, Taney 310. the text that the next of kin may file a bill to compel the company to discover the name of the transferee, and may join the company as defendant to a bill to compel the transferee to restore the shares to the estate).

Cf. *Marbury v. Ehlen*, 72 Md. 206; 19 Atl. 648; 20 Am. St. Rep. 467 (distinguishing *Albert v. Savings Bank*, 2 Md. 159); *Stewart v. Firemen's Ins. Co.*, 53 Md. 565.

² *Bayard v. Farmers', etc. Bank*, 52 Pa. St. 232 (semble).

³ *South-Western R. R. Co. v. Thomason*, 40 Ga. 408 (holding in addition to the proposition stated in

⁴ *Davis v. Nat. Eagle Bank* (R. I.), 50 Atl. 530.

⁵ *Wells v. Tyler*, 25 N. H. 340; *Graham v. First Nat. Bank*, 84 N. Y. 393; 38 Am. Rep. 528 (as to the right of the husband to collect dividends due his wife); *Burr v. Sherwood*, 3 Bradf. (N. Y.) 85. See also *supra*, § 834.

a shareholder, the title devolves upon the assignee or trustee,¹ who, however, may refuse to accept the shares if he deem the ownership onerous rather than advantageous.² The devolution of ownership upon the assignee or trustee in bankruptcy is "transmission" as distinguished from "transfer," and hence the company cannot decline to register the trustee in bankruptcy under a power to decline to register a transfer by any member who is indebted to it.³ The bankrupt remains the owner of the shares, so far as the company is concerned, until the name of the assignee or some note of the bankruptcy is entered on the company's register; and hence, until that time, notices of calls, forfeitures, and the like may be validly served on the bankrupt even though the company have notice of the bankruptcy.⁴ The company may accordingly be required to register an undischarged bankrupt as shareholder unless the assignee or trustee object.⁵ Moreover, a *bona fide* purchaser from the bankrupt will, when duly registered as shareholder, have a better title than the trustee in bankruptcy.⁶ But the shares cannot be attached on a proceeding against the bankrupt even though they still stand in the bankrupt's name.⁷ The company may be required by the assignee in bankruptcy to issue to him a share-certificate, and if a sufficient bond of indemnity be given, this may be done even though the bankrupt's certificate has been abstracted by the bankrupt and has never been cancelled or surrendered to the company.⁸ Where the assignee or trustee disclaims ownership of the shares they are, it seems, forfeited to the company.⁹

¹ The fullest consideration of this subject, confined of course to the English law, is contained in 1 Lindley on Companies (6th ed., p. 746 et seq.), Bk. III, Chap. 8.

² Supra, § 771. As to the rights of a trustee in bankruptcy to dividends, see *Bryan v. Sturgis Nat. Bank* (Tex.), 90 S. W. 704.

³ *Bentham Mills Co.*, 11 Ch. D. 900; *W. Key & Son* (1902), 1 Ch. 467 (trustee in bankruptcy entitled to be registered without addition of note indicating the company's claim of a lien for a disputed debt). Cf. *Ex parte Harrison*, 28 Ch. D. 363.

⁴ *Graham v. Van Diemen's Land Co.*, 1 H. & N. 541.

But see *Sutton v. English & Colonial Produce Co.* (1902), 2 Ch. 502.

⁵ *Sutton v. English & Colonial Produce Co.* (1902), 2 Ch. 502.

⁶ *London & Provincial Tel. Co.*, 9 Eq. 653.

⁷ *French v. White* (Vt.), 62 Atl. 35.

⁸ *Wilson v. Atlantic, etc. R. R. Co.*, 2 Fed. 459.

⁹ *Ex parte Hallett*, 1 Manson 380.

But cf. *Glenn v. Howard*, 65 Md. 40 (where the title was held to remain in the bankrupt, who was accordingly liable for subsequent calls).

§ 984. **Transmission or Devolution under Special Statute.** — Shares may be transmitted or devolved in consequence of some special statute. As respects shares owned by private persons, any such statute would ordinarily be obnoxious in America to constitutional objections, and would be so foreign to Anglo-Saxon conceptions of justice that it could never be passed by a British parliament. But where shares are owned by some public corporation, the case is different. For instance, a statute enacting that upon a certain day a school-board or other quasi-public body shall be “abolished” and its property “transferred” to a municipal corporation, has the effect of investing the latter corporation with complete legal title to stocks owned by the school-board and registered with the Bank of England, without the execution of any written transfer and without any registered transfer on the books of the Bank of England.¹

§ 985–§ 994. **TRUSTS OF SHARES AND EQUITABLE INTERESTS IN SHARES.**

§ 985. **Relevancy of Subject — Scope of Treatment.** — The subject of trusts of shares, or of equitable interests in shares, is closely connected with the subject of transfers of shares. Indeed, in almost every case of transfer of shares, the equitable title vests in the transferee some time before the legal title passes. Trusts of shares are governed by no peculiar principles not applicable to trusts in general,² and of course an attempt to state even in outline the general law of trusts would be wholly out of place here. The only attempt will be to set forth briefly the application of the general principles of the law of trusts to the peculiar circumstances of trusts of shares.

¹ *Oldham Corporation v. Bank of England* (1904), 2 Ch. 716.

² As to the power of trustees to invest in stocks or shares, see 1 Perry on Trusts, 2d ed., § 455, § 456. *Consterdine v. Consterdine*, 31 Beav. 330. As to whether trustees of shares may hold shares in subsidiary companies distributed to them upon a reduction of the capital of the principal company, see *supra*, § 665 or more persons as co-owners, but note.

§ 986. **Theory of a Trust applied to Shares.** — According to the theory of a trust, a trustee is a person who with respect to certain particular property is bound as between himself and another person, called the *cestui que trust*, to exercise his rights of ownership for the benefit of that other person. In other words, a trustee is a person who, owning certain property, holds for the benefit of another person.¹ Hence, the trust is something with which the company and other third persons have nothing whatever to do, beyond refraining from any action which could be construed as participation or connivance in a breach of trust. The trustee and not the *cestui que trust* is the person whom the company recognizes as the owner of the shares.² Thus, the trustee and not the *cestui que trust* is entitled to vote in respect of the shares.³ For this reason, a trustee is liable personally as a shareholder although the shares stand on the register in his name as trustee.⁴ The *cestui que trust* is not a person "entitled to shares as against the company";⁵ his right is against the trustee alone. Hence, it is deemed a matter of entire indifference to the company who may be *cestui que trust* of its shares:⁶ the trustee is the person with whom alone the company has to deal.

§ 987. **Tendency of American Courts to depart from this Principle.** — Undoubtedly, many American courts would not follow out logically this theory of a trust, but would treat the trustee as, so to speak, a personification of the trust estate, the estate being regarded as constituting, as it were, a legal entity.

§ 988. **The Principle emphasized in England — Companies Act, 1862, § 30.** — In England, however, the principle is not merely accepted and applied but is even extended and emphasized by custom and reinforced by statute. Section 30 of the Companies Act, 1862, provides that, in the case of English or Irish as distinguished from Scotch companies, no notice of any trust, expressed, implied, or constructive, shall be entered on the register of members or be receivable by the registrar. By a narrow con-

¹ Conversely, a person who holds shares or other property "for the behoof of" another is a trustee. *Gillespie v. City of Glasgow Bank*, 4 A. C. 632.

² Cf. *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806.

³ See *infra*, § 1223.

⁴ *Muir v. City of Glasgow Bank*, 4 A. C. 337. See *supra*, § 767.

⁵ *Re Perkins*, 24 Q. B. D. 613.

⁶ *Bell Bros.*, 65 L. T. 245, 248.

struction of this statute, it might have been held that while the company was exempted from any obligation to enter the trust on the register, so as to afford notice thereof to all persons inspecting the register, still it should not be relieved from the duty of itself recognizing any trusts or equities of which it might have notice from any source. Such, however, has not been the construction adopted by the courts. The act exonerates the company from registering an absolute transfer from a trustee to the tenant for life to the prejudice of the remaindermen, although the company had notice of the terms of the trust.¹ On the other hand, the statute does not authorize the company wantonly to disregard the equities of the *cestui que trust*. For instance, if the company has under its regulations a lien upon its shares for the debts of the holders, it may not set up its lien to the prejudice of the *cestui que trust* in respect of advances made after it had actual notice of the trust.² On the other hand, perhaps, even this latter almost unreasonable power may be conferred upon the company by an explicit provision in the articles of association.³

The section of the Companies Act which we are now considering had its origin and prototype in a custom or by-law of the Bank of England, which refused (and still refuses) to enter upon its books any trusts of stock.⁴ The principle which lies at the root of the statute is very far-reaching; and oftentimes it is difficult to determine whether a decision of an English court as to equitable interests in shares rests upon this statutory provision or upon general principles of company law.⁵

Lord Coleridge, in terms which are not inapplicable in America, has forcibly expressed the importance of recognizing that the trustee is the only person with whom the company has anything to do and that whether he holds the shares beneficially

¹ *Simpson v. Molson's Bank* (1895), A. C. 270, 279 (construing a similar provision in a Canadian statute).

² *Bradford Banking Co. v. Briggs*, 12 A. C. 29; *McLaughlin v. Bank of Victoria*, 20 Vict. L. R. 433.

³ Cf. *New London Bank v. Brocklebank*, 21 Ch. D. 302. See *Palmer's Company Law*, 3d ed., pp. 113-117.

⁴ Cf. *Law Guarantee Soc. v. Bank of England*, 24 Q. B. D. 406.

⁵ For cases in which the decision has been more or less affected by the statutory provision, see *Re Perkins*, 24 Q. B. D. 613; *Société Générale de Paris v. Tramways Union*, 14 Q. B. D. 424; *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77.

or upon trust is no concern of the company. "It seems to me," said that learned judge, "extremely important not to throw any doubt on the principle that companies have nothing whatever to do with the relations between trustees and their *cestuis que trust* in respect of the shares of the company. If a trustee is on the company's register as a holder of shares, the relations which he may have with some other person in respect of the shares are matters with which the company have nothing whatever to do. They can only look to the person whose name is on the register."¹

§ 989. **Obligation of Company to protect Cestui Que Trust of Shares.** — Apart from provisions such as that found in the British Companies Act of 1862, based upon the rule of the Bank of England and referred to above, a corporation is undoubtedly bound like any other person to respect equitable rights of which it has notice.² It is liable to the *cestui que trust* if after notice of the trust it permits the trustee to deal with the shares in a way inconsistent with the just rights of the *cestui que trust*;³ and may therefore refuse to register any transfer which it knows to have been executed by the trustee in disregard of his trust.⁴ A local custom to the contrary will not have effect, at any rate not unless shown to have been known to the *cestui que trust*.⁵ For instance, if the company issues to the trustee a share-certificate which does not indicate on its face the existence of the trust, whereby the trustee is enabled to convey the shares to a purchaser for value, the company must make good the *cestui que trust's* loss.⁶ So, if the company, being charged with notice of a trust for A for life with remainder over, registers the shares in the name of the trustee as "trustee for A," thus enabling the

¹ *Re Perkins*, 24 Q. B. D. 613, 616.

² *Lowry v. Commercial, etc. Bank*, Taney 310, 335; *Guarantee Co. v. East Rome Town Co.*, 96 Ga. 511; 23 S. E. 503; 51 Am. St. Rep. 150; *Bayard v. Farmers', etc. Bank*, 52 Pa. St. 232.

But see *Sylvania, etc. R. Co. v. Hoge* (Ga.), 59 S. E. 806 (holding that the company cannot refuse to recognize a transfer in violation of a pooling agreement between shareholders).

³ *Geyser-Marion Co. v. Stark*, 106 Fed. 558; 45 C. C. A. 467; *Marbury v. Ehlen*, 72 Md. 206; 19 Atl. 648; 20 Am. St. Rep. 467; *Stewart v. Firemen's Ins. Co.*, 53 Md. 565.

Cf. *Bank of Kentucky v. Winn*, 61 S. W. 32; 110 Ky. 140.

⁴ *Young v. New Standard Concentrator Co.* (Cal.), 83 Pac. 28.

⁵ *Geyser-Marion, etc. Co. v. Stark*, 106 Fed. 558; 45 C. C. A. 467.

⁶ *Loring v. Salisbury Mills*, 125 Mass. 138.

trustee to transfer the shares to A, and enabling A to transfer to *bona fide* purchasers, the company must make good the loss to the remainderman.¹

§ 990. **What amounts to Notice of Existence and Terms of Trust.**—What will amount to notice of a trust or of the terms of a trust of shares, is a question upon which the authorities are not agreed.² The question would seem to be governed by no peculiar principles applicable to shares and not to other species of property. Where the trust is created by the will of a deceased shareholder, the company's knowledge of the existence of a will has been held to be constructive notice of the contents of the will, and consequently of the terms of the trust,³ so that a registration of a transfer from the executors to a legatee without protecting all the *cestuis que trust* will be wrongful.⁴ The fact that a share-certificate states that the shares represented thereby are held "in trust" is sufficient to charge the company and any transferee with notice of the trust so as to prevent the transferee from claiming the rights of a purchaser for value in opposition to the *cestui que trust*,⁵ and to render the company liable if it registers the transfer without ascertaining the power of the trustee to make the transfer,⁶ and *a fortiori* where the person described as trustee pledges the shares to secure his individual debt the pledgee is not deemed a *bona fide* purchaser.⁷

¹ *Wooten v. Wilmington, etc. R. Co.*, 38 S. E. 298 (N. Car.); 128 N. C. 119; 56 L. R. A. 615.

² Cf. *Simpson v. Molson's Bank* (1895), A. C. 270; *Spelissy v. Cook & Bernheimer Co.*, 58 N. Y. App. Div. 283; 68 N. Y. Supp. 995.

³ *Caulkins v. Gas-Light Co.*, 85 Tenn. 683; 4 S. W. 287; 4 Am. St. Rep. 786; *Marbury v. Ehlen*, 72 Md. 206; 19 Atl. 648; 20 Am. St. Rep. 467; *Stewart v. Firemen's Ins. Co.*, 53 Md. 565, 575-576; *Lowry v. Commercial, etc. Bank*, Taney 310.

⁴ *Wooten v. Wilmington, etc. R. Co.*, 38 S. E. Rep. 298 (N. Car.); 128 N. C. 119; 56 L. R. A. 615.

Cf. *Caulkins v. Gas-Light Co.*, 85 Tenn. 683; 4 S. W. 287; 4 Am. St. Rep. 786.

If the company has reason to

suppose that the transfer by executors is a *sale* for purpose of administration, this liability would not attach. See *supra*, § 981.

⁵ *Bank of Montreal v. Sweeny*, 12 A. C. 617.

Cf. *Prall v. Tilt*, 28 N. J. Eq. 479; *First Nat. Bank v. National Broadway Bank*, 156 N. Y. 459; 51 N. E. 398; 42 L. R. A. 139; *Johnson v. Amberson*, 37 So. 273; 140 Ala. 342.

⁶ *Geyser-Marion, etc. Co. v. Stark*, 106 Fed. 558; 45 C. C. A. 467; *Marbury v. Ehlen*, 72 Md. 206; 19 Atl. 648; 20 Am. St. Rep. 467 (distinguishing *Albert v. Savings Bank*, 2 Md. 159, which latter case is reaffirmed in *Grafflin v. Robb*, 84 Md. 451; 35 Atl. 971).

⁷ *Shaw v. Spencer*, 100 Mass. 382; 97 Am. Dec. 107; 1 Am. Rep.

But other cases hold that the word "trustee" alone is not sufficient to put a purchaser on inquiry,¹ and some few apply the same rule even in cases of hypothecation by the person named as trustee to secure his own debt.² According to all the authorities where the name of the *cestui que trust* is communicated to the corporation, it is bound to protect his rights.³ But if the share-certificate does not disclose the existence of the trust, the purchaser is not bound to examine the books of the company in order to see whether the shares be held in trust.⁴ The mere fact that shares are held by two or more persons jointly is no indication of the existence of a trust.⁵

§ 991. **Liability of Trustee's Bond.** — If the trustee has given bond for the faithful performance of his trust, the bond is of course answerable for any wrongful transfer by the trustee. *Prima facie*, the measure of damages would be the value of the shares transferred; but if the company was party to the breach of trust and has been compelled to pay the value of the shares, the bondsmen are liable for no more than nominal damages.⁶ They cannot, it was held, be made liable under the bond for the benefit of the company, which is regarded as a joint tortfeasor in confederation with the misconducting trustee. This was held in a case where the transfer by the fiduciary was invalid under a statute which avoided any transfer by a guardian made without a prior order of court sanctioning it. The decision was a harsh one, inasmuch as the corporation did not appear to have been guilty of any intentional wrongdoing, and *a fortiori* the same rule would apply where the company knowingly connives at a wrongful transfer by a trustee.

§ 992. **Change of Trustees.** — A resignation of a trusteeship and the substitution of another trustee partakes of the nature of a transfer of the trust shares. The mere resignation of the

115; *Budd v. Munroe*, 18 Hun (N. Y.) 316; *Clemens v. Heckscher*, 185 Pa. St. 476; 40 Atl. 80.

But cf. *Ashton v. Atlantic Bank*, 3 Allen (Mass.) 217.

¹ *Grafflin v. Robb*, 84 Md. 451; 35 Atl. 971 (distinguishing *Marbury v. Ehlen*, 72 Md. 206; 19 Atl. 648; 20 Am. St. Rep. 467; and reaffirming *Albert v. Savings Bank*, 2 Md. 159).

² *Brewster v. Sime*, 42 Cal. 139; *Thompson v. Toland*, 48 Cal. 99.

³ *Bayard v. Farmers', etc. Bank*, 52 Pa. St. 232.

⁴ *Salisbury Mills v. Townsend*, 109 Mass. 115; *Lowry v. Commercial, etc. Bank*, Taney 310.

⁵ See *infra*, § 1008.

⁶ *State use Murray v. Murray*, 24 Md. 310; 87 Am. Dec. 608.

trust does not cause the trustee to cease to be a shareholder or relieve him from a shareholder's liabilities.¹ It is not even enough that his resignation is communicated to the directors; there must be a transfer by the resigning trustee or something in the nature of a transfer, in order that the trustee's liabilities as shareholder may terminate.² An execution, by two Scotch trustees of shares, of a deed "assuming" new trustees, followed by a note on the stock ledger giving the names of the "assumed" trustees and entered with their consent, is equivalent to a transfer into the names of the new trustees and renders them shareholders in the company.³

§ 993—§ 994. *Assignments of Equitable Interests in Shares.*

§ 993. **In general.** — A *cestui que trust* or equitable owner of shares may of course assign his interest; but since the shares stand in the name of the trustee, to whom also the certificate is issued, the *cestui que trust* cannot deliver or endorse the certificate to his transferee, and cannot clothe his transferee with the right to demand that the company register him as shareholder. The utmost right that a *cestui que trust* can confer upon the transferee is the right to require the trustee to execute a transfer and deliver to him the certificate, to the end that he may be registered as legal owner of the shares; and even this can be done by the *cestui que trust* only in the case of a bare trust. The transfer of a *cestui que trust's* interest is naturally accomplished by very different means from those employed where the legal title is to be transferred. An assignment of the *cestui que trust's* interest, like "all grants and assignments of any trust or confidence," is required, by the ninth section of the Statute of Frauds, to "be in writing signed by the party granting or assigning the same or else shall . . . be utterly void and of none effect." With this exception, no form or ceremony is requisite. Even if the assignment be gratuitous, it is irrevocable from the execution and delivery of the written transfer, without any further act or ceremony;⁴ for a voluntary transfer of an equitable

¹ *A. Mitchell's Case*, 4 A. C. 548;
Rutherford's Case, 4 A. C. 548; *Ker's*
Case, 4 A. C. 549.

² *Bell's Case*, 4 A. C. 547.

³ *A. Mitchell's Case*, 4 A. C. 548;
Rutherford's Case, 4 A. C. 548.

⁴ *Nanney v. Morgan*, 37 Ch. D.
346.

right is complete as soon as the assignor has done everything that the nature of the case admits of to put the subject of the gift out of his control and within the dominion of the assignee.

In order to perfect the assignment, it may be necessary for the assignee to notify the trustee, but it is not necessary to give notice to the company.¹ As the assignment does not confer any legal as distinguished from equitable rights, the transferee is not entitled to stand as a purchaser of the shares without notice of an outstanding prior equity superior to the title of the trustee or person in whose name the shares stand.²

§ 994. **Assignments by Shareholders who have assented to Voting Trusts, Reorganization Schemes, etc.** — The law of assignments of equitable interests in shares has been applied in cases of voting trusts, reconstruction and amalgamation schemes, and similar arrangements. The shareholders who put their shares into the trust or pool receive from the trustees certain certificates or scrip which really represent equitable interests in the shares and which are intended to be and are assignable in much the same way as the shares themselves would be.³ The trust-certificates or scrip are to be treated, as far as possible, like share-certificates. Like them, they are assigned by endorsement. The assignment is consummated by an entry on the transfer books of the trust or pool. The duty of the trustees to enter the transfer on the books is the same as that of a corporation to enter on its books a transfer of its shares; and the duty is enforceable in the same way.⁴ If the trust is illegal, it may be revoked at any time by the holders of the trust certificates; and a transferee has the same right in this respect as an original holder.⁵ If the trustee or depositary under a reorganization scheme issues a certificate to one who falsely represents himself to be owner of certain of the deposited shares, nevertheless the true owner of the shares in question (who had not assented to

¹ *Houser v. Richardson*, 90 Mo. App. 134.

Cf. *Etty v. Bridges*, 2 Y. & Colly. Ch. 486 (relating to an equitable interest in bank annuities or stock, not capital stock of the company, where there was no trustee in existence).

² *Barker v. Montana Gold, etc. Co.* (Mont.), 89 Pac. 66.

³ Cf. *Hubbard v. Manhattan Trust Co.*, 87 Fed. 51, 57-58; 30 C. C. A. 520, and also *supra*, § 237.

⁴ *Rice v. Rockefeller*, 134 N. Y. 174; 31 N. E. 907; 30 Am. St. Rep. 658; 17 L. R. A. 237.

⁵ *Shepaug Voting Trust Cases*, 60 Conn. 553; 24 Atl. 32.

the reorganization plan) cannot compel the trustee or depository to issue to him the securities in the new company represented by the certificate, unless the certificate be first actually delivered up; and this is true even though the holder of the certificate be a party to the suit and be ordered by decree to surrender the certificate; for if he should disobey the decree, the trustee would be liable to a *bona fide* transferee of the certificate.¹

§ 995—§ 1005. PLEDGES AND MORTGAGES OR HYPOTHECATION OF SHARES.

§ 995. **Confusion in Law of Mortgages in general.** — The law of mortgages and similar charges in the United States is involved in great confusion, irrespective of the nature of the mortgaged property — whether real estate, personal chattels, or choses in action. In some states a mortgage is deemed a conveyance of the legal title to the mortgagee; in others it is regarded, even at law, as a mere lien. In some states the distinction between law and equity has been obliterated, while in others it is preserved in all its sharpness. Although substantial justice is accomplished almost everywhere, the uncertainty as to the theory upon which the results are reached is far from creditable to American jurisprudence. That this confusion which envelops the whole law of mortgages should be intensified when the law is applied to property of so peculiar a kind as shares in incorporated companies is not surprising.

§ 996. **Difficulty in applying general Principles of Law to Mortgages and Pledges of Shares — Distinction between "Pledge" and "Mortgage" of Shares.** — As applied to shares, even the logical simplicity of the English common law of mortgages and pledges becomes uncertain and intricate. For one thing, there is, as we have seen above, considerable uncertainty and conflict of authority in respect to what formalities if any are necessary in order to effect a transfer of the legal title to shares. Moreover, transfer of possession is a *sine qua non* of a valid pledge of personal property; and, in the existing state of the authorities, who can say what are the elements of possession of the

¹ *Bean v. Am. L. & T. Co.*, 122 N. Y. 622; 26 N. E. 11.

incorporeal personal property known as shares or stock?¹ Indeed, some authorities have gone so far as to maintain that shares in corporations, not being capable of possession, cannot be the subject of a pledge. Certain it is that the use of the terms "mortgage," "pledge," etc., as applied to shares is more likely to mislead than instruct. From the fact that shares held as collateral security are said by one court to be "pledged," and by another to be "mortgaged," no inference can safely be drawn that the rights of the parties would be held to be different by the two tribunals. Terms which are useful as applied to charges upon land or personal chattels are worse than useless as applied to shares. Hence, to discuss which charges or liens upon shares in a corporation are properly denominated "mortgages" and which "pledges" would be largely a waste of time and battle about words.² The term "pledge" is frequently used in this work, for want of a better word, to designate a charge or lien upon shares; but the word is used as a generic term and not in any technical sense, as distinguished from a mortgage, equitable charge, or security of a different nature. All such classifications will be disregarded as unfortunate and misleading; and in lieu thereof a classification suited to the peculiarities of shares in incorporated companies will be adopted.

§ 997. **Classification of Charges or Liens upon Shares.**—Charges or liens upon shares may, then, be divided into five classes: (1) where there is an agreement, oral or written, that the shares shall be held as security for a debt, no formal transfer being executed and the indicia of ownership, notably the share-

¹ Supra, § 834.

² Cf. *Barse Live Stock Co. v. Range Valley Cattle Co.*, 16 Utah 59; 50 Pac. 630 (hypothecation of shares in ordinary way held not to be within a chattel mortgage act); *Hasbrouck v. Vandervoort*, 4 Sandf. (N. Y.) 74 (where the court said that the transaction was a pledge but that the legal title passed to the pledgee); *Wilson v. Little*, 2 N. Y. 443; 51 Am. Dec. 307; *Doak v. Bank of the State*, 6 Ired. Law (N. Car.) 309; *Mechanics Bldg., etc. Ass'n v. Conover*, 14 N. J. Eq. 219 (as to a pledge or mortgage to the corporation); *Rice*

v. Gilbert, 173 Ill. 348; 50 N. E. 1087; *Manns v. Brookville Nat. Bank*, 73 Ind. 243; *Campbell v. Woodstock Iron Co.*, 83 Ala. 351; 3 So. 369; *Greene v. Dispeau*, 14 R. I. 575, 576; *Bryson v. Rayner*, 25 Md. 424; 90 Am. Dec. 69; *Richardson v. Longmont Supply Ditch Co.*, 19 Colo. App. 483; 76 Pac. 546; (hypothecation not a mortgage within meaning of statute limiting time for foreclosing chattel mortgages); *Irving Park Ass'n v. Watson*, 67 Pac. 945; 41 Oreg. 95 (hypothecation of shares not within statute relating to foreclosure of chattel mortgages).

certificate, being retained in the possession of the debtor; (2) where the share-certificate is delivered to the creditor but without any transfer or endorsement sufficient to enable the creditor to have himself registered as the owner or to sell the shares in the market, without some further act on the part of the debtor; (3) where the certificate is delivered to the debtor coupled with a transfer or blank endorsement; (4) where the shares are transferred to the creditor on the books of the company but coupled with an entry indicating that they are held as collateral security merely, and (5) where the shares are transferred to the creditor on the company's books, no entry being made to indicate that they are held as collateral security and no communication of that fact being made to the company. We shall now consider the rights of the parties in these several cases, without pausing to inquire whether the transactions are more properly denominated pledges or mortgages.

(1) § 998. **Mere Agreement that Shares shall be held as Collateral Security.**—The transaction in this case evidently amounts to no more than an executory contract to hypothecate the shares for payment of the debt. Such a contract, however, should, it is submitted, be enforced specifically in equity, so that it may amount, virtually, to an equitable charge.¹ The creditor obviously has no means of enforcing his rights, or of obtaining any control over the shares without the aid of a court of equity. Hence, if the debtor be a sovereign state and as such exempt from suit, the creditor is without remedy to enforce the charge or contract.²

¹ *Schwind v. Boyce*, 94 Md. 510; 51 Atl. 45. Cf. *Harris's Appeal*, 12 Atl. Rep. 743 (Pa.); *First Nat. Bank v. Bacon*, 113 N. Y. App. Div. 612; 98 N. Y. Supp. 717; *Dexter Horton & Co. v. McCafferty* (Wash.), 84 Pac. 733.

But see *Atkinson v. Foster*, 134 Ill. 472; 25 N. E. 528 (where the lien was held invalid even in equity as against the general creditors); *Nisbit v. Macon Bank, etc. Co.*, 12 Fed. 686. Cf. *Campbell v. Woodstock Iron Co.*, 83 Ala. 351; 3 So. 369; *Girard Trust Co. v. Mellor*, 156 Pa. St. 579; 27 Atl. 662; *Lallande v. Ingram*, 19 La. Ann. 364; *Succession of Lanoux*, 46 La. Ann. 1036; 15 So. 708; 25 L. R. A. 577; *Third Nat. Bank v. Buffalo German Ins. Co.*, 193 U. S. 581; 24 Sup. Ct. 524 (agreement held, in accordance with settled principles of law, inoperative against a subsequent bona fide pledgee of the share-certificate).

² *Christian v. Atlantic & North Carolina R. R. Co.*, 133 U. S. 233 (where the creditor attempted to proceed against the corporation).

(2) § 999. **Agreement coupled with Delivery of Share-Certificate without Transfer or Endorsement.** — In this case as in the preceding, the creditor must resort to equity to obtain specific performance of the contract of hypothecation. The mere possession of the share-certificate does not enable him to transfer the shares or to have himself registered as the owner. It does, however, enable him to embarrass the debtor if the latter should attempt to dispose of the shares in violation of his agreement with the former, and by refusing to surrender the certificate the creditor may often extort from the debtor either payment of the debt or some more effective pledge of the shares. In such a case as this, the creditor might be deemed a pledgee of the certificate considered merely as a chattel, and as such entitled to hold the certificate precisely as the pledgee of a coat or a hat would be entitled to do.¹ However, it has been held that the creditor may have a strict foreclosure, and is not limited to his remedy by sale of the shares as an ordinary pledgee of a chattel would be.²

(3) § 1000-§ 1002. *Delivery of Share-Certificate coupled with Transfer or Endorsement in Blank.*

§ 1000. **Rights of Creditor with respect to Third Persons.** — This case illustrates the ordinary method of hypothecating shares. In many respects the creditor's rights are the same as those of a transferee under an absolute transfer, to whom the share-certificate has been delivered coupled with a transfer signed by the transferor but who has not yet been registered as a shareholder. This is certainly the case in so far as the rights and liabilities of the pledgee with reference to the corporation or any third person are concerned. For example, if the pledgor was a trustee who was disposing of the shares in violation of his trust, the question whether a person to whom the certificate has been delivered coupled with a transfer in blank is to be deemed a *bona fide* holder for value without notice and therefore entitled to hold the shares as against the *cestui que trust* is precisely the

¹ Cf. *Wagner v. Marple*, 10 Tex. *Loveman v. Henderson*, 1 Tenn. Ch. Civ. App. 505; 31 S. W. 691; *Nisbit* App. 749.
v. Macon Bank, etc. Co., 12 Fed. 686; ² *Harrold v. Plenty* (1901), 2 Ch.

314.

same whether the transfer be intended as absolute or as collateral security merely. So, too, the question whether the holder of the certificate with the endorsed transfer is to be preferred to a person claiming under another transfer from the same transferor is precisely the same whether the first-mentioned transfer was absolute or by way of collateral security.

The debtor, being the registered owner, is entitled to collect any dividends payable upon the shares.¹ If, however, the creditor notify the company of the hypothecation, he has been held to be entitled to recover from the company any such dividends.² The creditor under such circumstances has been allowed to maintain the action even though the debt had been paid, the theory of the court being that the amount collected would be held for the use of the debtor;³ but it would seem that the action should have been brought in the debtor's name. If the debtor collects dividends declared on the shares after the contract of hypothecation, the creditor is entitled to require him to account for the same, for such dividends are part of the creditor's security.⁴

§ 1001. **Rights of Creditor and Debtor Inter Sese.** — The rights of the debtor and the creditor *inter sese* in the case we are now considering are as follows: The transfer in blank as collateral security authorizes the creditor to fill up the blank with his

¹ *Hill v. Newichawanick Co.*, 8 Hun 459, affirmed on opinion below, 71 N. Y. 593; *Gemmell v. Davis*, 75 Md. 546; 23 Atl. 1032; 32 Am. St. Rep. 412.

Cf. *Hermann v. Maxwell*, 47 N. Y. Super. Ct. 347 (holding the debtor a trustee of the dividends for the creditor); *Meredith Village Savings Bank v. Marshall*, 68 N. H. 417; 44 Atl. 526 (same point as preceding case); *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120; 22 N. E. 524 (holding that the creditor has no claim to dividends declared prior to the pledge).

² *Gaty v. Holliday*, 8 Mo. App. 118, 119 (semble); *Guarantee Co. v. East Rome Town Co.*, 96 Ga. 511; 23 S. E. 503; 51 Am. St. Rep. 150 (company paying dividends to debtor with notice of the hypothe-

cation liable over again to the creditor); *Central Nebr. Nat. Bank v. Wilder*, 32 Nebr. 454; 49 N. W. 369 (same point as last case).

Cf. *Gemmell v. Davis*, 75 Md. 546; 23 Atl. 1032; 32 Am. St. Rep. 412.

³ *Guarantee Co. v. East Rome Town Co.*, 96 Ga. 511; 23 S. E. 503; 51 Am. St. Rep. 150.

⁴ *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120, 134 (headnote inadequate); 22 N. E. 524; *Gaty v. Holliday*, 8 Mo. App. 118 (overruling the objection that the creditor's only remedy was against the corporation which had paid the dividends to the debtor after notice of the creditor's claim).

Cf. *Page Belting Co. v. Prince* (N. J.), 67 Atl. 401; *Highett v. Highett*, 22 Vict. L. R. 352.

own name as transferee and to have the transfer registered;¹ and if the company refuses to recognize him as shareholder he may avail of any appropriate remedy that would have been available if the transfer had been absolute instead of as collateral security merely.² Instead of putting the shares in his own name, he may put them in the name of an agent or nominee.³ Whether the creditor must keep the hypothecated shares separate and distinct or whether he may mingle them indiscriminately with other shares of the same kind standing in his name will depend on the terms of the contract as interpreted in the light of the surrounding circumstances and of the customs or usages of the trade.⁴ Moreover, in England the creditor is entitled to repledge the shares as security for his own indebtedness, conferring upon the second pledgee the right to hold the shares as security until the first debt is paid off.⁵ If a mort-

¹ *Davies' Case*, 33 L. T. 834; Fed. 366; 5 C. C. A. 134 (where the debt was barred by limitations).

Ex parte Sargent, 17 Eq. 273 (criticised in *France v. Clarke*, 26 Ch. D. 257); *Skiff v. Stoddard*, 63 Conn. 198, 217-218; 26 Atl. 874; 28 Atl. 104; 21 L. R. A. 102; *Union, etc. Bank v. Farrington*, 13 Lea (Tenn.) 333; *Day v. Holmes*, 103 Mass. 306 (holding further that the creditor may put the shares in the name of an agent); *Hubbell v. Drexel*, 11 Fed. 115; *Feige v. Burt*, 118 Mich. 243; 77 N. W. 928; 74 Am. St. Rep. 390 (semble); *Rich v. Boyce*, 39 Md. 314 (custom to the contrary held unreasonable and void); *Davis v. Hardwick* (Tex.), 94 S. W. 359.

Cf. Commercial Bank v. Kortright, 22 Wend. 348; 34 Am. Dec. 317; *Horton v. Morgan*, 19 N. Y. 170; 75 Am. Dec. 311.

But see contra: where no default has been made in payment of the debt. *Spreckels v. Nevada Bank*, 113 Cal. 272; 45 Pac. 329; 33 L. R. A. 459; 54 Am. St. Rep. 348. *Cf. State ex rel. Canal Bank v. North American Land, etc. Co.*, 112 La. 441; 36 So. 488.

² *Herbert Kraft Co. v. Bank of Orland*, 65 Pac. 143; 133 Cal. 64; *Miller v. Houston City Ry. Co.*, 55

Cf. Wadlinger v. First Nat. Bank, 209 Pa. 197; 58 Atl. 359 (as to making the pledgor a party).

³ *Day v. Holmes*, 103 Mass. 306; *Hiatt v. Griswold*, 5 Fed. 573, 576-577 (where the creditor transferred the shares from his own name in order to avoid liability as a shareholder); *Rankin v. Fidelity Trust Co.*, 189 U. S. 242, 252, 254; 23 Sup. Ct. 553; *Higgins v. Fidelity Ins., etc. Co.*, 108 Fed. 475, 477; 46 C. C. A. 509.

Cf. Terry v. Birmingham Nat. Bank, 93 Ala. 599; 9 So. 299; 30 Am. St. Rep. 87; *Smith v. Becker* (Wisc.), 109 N. W. 131.

⁴ See supra, § 500.

⁵ *France v. Clark*, 26 Ch. D. 257.

Contra: *Westinghouse v. German Nat. Bank*, 188 Pa. St. 630; 41 Atl. 734 (rehypothecation forbidden by statute).

Cf. Fay v. Gray, 124 Mass. 500; *Skiff v. Stoddard*, 63 Conn. 198, 218-220, 231; 26 Atl. 874; 28 Atl. 104; 21 L. R. A. 102; *Price v. Gover*, 40 Md. 102, 115-116; *Lawrence v. Maxwell*, 53 N. Y. 19; *New York, etc. R. R. Co. v. Davies*, 38 Hun (N.

gagee assumes to do more than this, he is exceeding his actual authority, and his dealings with the shares can be sustained, if at all, only on the principle of estoppel. That such an estoppel will be raised in favor of a *bona fide* transferee of the certificate is the general American rule.¹

In general, we may say that the rights and remedies of the parties are the same as in case of a pledge of tangible personal property, leaving a detailed statement of such rights and remedies to books which deal specifically with pledges of personal property. For example, if default be made in payment of the debt, the creditor may, as in case of pledge of tangible personal property, if he be willing to assume the risk, sell the shares by public sale² although not by private sale;³ but must first demand payment of the debt⁴ and also must give the debtor reasonable notice of the time and place of sale,⁵ any custom

Y.) 477; *German Sav. Bank v. Renshaw*, 78 Md. 475; *Oregon & Transcontinental Co. v. Hilmers*, 20 Fed. 717.

¹ *McNeil v. Tenth Nat. Bank*, 46 N. Y. 325; 7 Am. Rep. 341; *Brittan v. Oakland Bank of Savings*, 124 Cal. 282; 57 Pac. 84; 71 Am. St. Rep. 58; *Westinghouse v. German Nat. Bank*, 188 Pa. St. 630, 632; 41 Atl. 734; *Gilbert v. Erie Bldg. Ass'n* (Pa.), 39 Atl. 291 (semble); *Commercial Bank v. Kortright*, 22 Wend. (N. Y.) 348; 34 Am. Dec. 317; *O'Mara v. Newcomb* (Colo.), 88 Pac. 167. See also *supra*, § 896.

But see *German Sav. Bank v. Renshaw*, 78 Md. 475; *Kern's Estate*, 176 Pa. St. 373 (headnote inadequate); 35 Atl. 231.

² *Brown v. Ward*, 3 Duer (N. Y.) 660.

³ *Diller v. Brubaker*, 52 Pa. St. 498; 91 Am. Dec. 177; *Baltimore Marine Ins. Co. v. Dalrymple*, 25 Md. 269.

As to whether a sale on the stock exchange is a private sale, see *Brass v. Worth*, 40 Barb. (N. Y.) 648, 653-654; *Willoughby v. Comstock*, 3 Hill (N. Y.) 389; *Child v. Hugg*, 41 Cal. 519; *Maryland Fire Ins. Co. v.*

Dalrymple, 25 Md. 242; *Rankin v. McCullough*, 12 Barb. (N. Y.) 103; *Tucker v. Wilson*, 1 P. Wms. 261; 5 Bro. P. C. 193.

⁴ *Wilson v. Little*, 2 N. Y. 443; 51 Am. Dec. 307; *Nabring v. Bank of Mobile*, 58 Ala. 204.

But see *Franklin Nat. Bank v. Newcombe*, 1 N. Y. App. Div. 294; 37 N. Y. Supp. 271 (where a definite time for payment was fixed by the contract).

⁵ *Stenton v. Jerome*, 54 N. Y. 480; *Markham v. Jandon*, 41 N. Y. 235; *Gillett v. Whiting*, 120 N. Y. 402; 24 N. E. 790 (with which cf. s. c., 141 N. Y. 71; 35 N. E. 939; 38 Am. St. Rep. 762, where the objection was held to have been waived); *Stevens v. Hurlbut Bank*, 31 Conn. 146 (notice of less than one day held insufficient); *Hempfling v. Burr*, 59 Mich. 294; 26 N. W. 496; *Feige v. Burt*, 118 Mich. 243; 77 N. W. 928; 74 Am. St. Rep. 390; *Conyngham's Appeal*, 57 Pa. St. 474; *McCutcheon v. Dittman*, 23 N. Y. App. Div. 285; 48 N. Y. Supp. 360 (forwarding newspaper advertisement of sale to debtor held insufficient notice); *Furber v. National Metal Co.*, 103 N. Y. Supp. 490 (as to the necessity of

of brokers to the contrary notwithstanding,¹ unless the contract of hypothecation is expressly made subject to such usage.² The place of sale must be a reasonable one.³ The sale may be complete so as to cut off the debtor's right of redemption although the transfer is never entered on the books of the company, the shares standing all the time in the name of a clerk of the creditor's broker, and although the same certificate ultimately gets back into the hands of the creditor.⁴ It has been held in California that an irregular sale is not a forfeiture of all title to the shares, but passes to the purchaser the right of the creditor to hold them until the debt is paid.⁵ If the creditor desire to have the protection of a court of equity, he may file a bill for the purpose of realizing on his security,⁶ and, at least, according to the English law, may, if he so elect, have a strict foreclosure instead of a sale.⁷

In order to confer these various rights upon the creditor as between himself and his debtor, the certificate must have been delivered to him with intent to secure the particular indebtedness in question. For instance, if a certificate endorsed in blank is delivered to a creditor to secure a debt which is after-

giving a new notice when sale is postponed at debtor's request from date first fixed therefor).

But see *Wallace v. Burdell*, 24 Hun (N. Y.) 379; *McDowell v. Chicago Steel Works*, 124 Ill. 491; 16 N. E. 854; 7 Am. St. Rep. 381 (where the contract authorized the pledgee to sell at either public or private sale); *Worthington v. Torrey*, 34 Md. 182 (dispensing with notice of the place of sale); *Deverges v. Sandeman, Clark & Co.* (1902), 1 Ch. 579.

Cf. *Alexandria, etc. R. R. Co. v. Burke*, 22 Gratt. (Va.) 254; *Bryan v. Baldwin*, 52 N. Y. 232; *Neiler v. Kelley*, 69 Pa. St. 403.

¹ *Markham v. Jandon*, 41 N. Y. 235.

² *Baker v. Drake*, 66 N. Y. 518; 23 Am. Rep. 80.

³ Cf. *Guinzberg v. H. W. Downs Co.*, 165 Mass. 467; 43 N. E. 195; 52 Am. St. Rep. 525 (where the debtor had waived the objection).

⁴ *Smith v. Becker* (Wisc.), 109 N. W. 131.

As to a sale accompanied or followed by a repurchase by the creditor, see *Macoun v. Erskine, Oxenard & Co.* (1901), 2 K. B. 493; *Erskine, Oxenard & Co. v. Sachs* (1901), 2 K. B. 504; *Walter v. King*, 13 Times L. R. 270.

⁵ *Brittan v. Oakland Bank of Savings*, 124 Cal. 282; 57 Pac. 84; 71 Am. St. Rep. 58.

⁶ *Vaupell v. Woodward*, 2 Sandf. Ch. (N. Y.) 143; *Plankinton v. Hildebrand*, 89 Wisc. 209; 61 N. W. 839; *Conyngham's Appeal*, 57 Pa. St. 474.

Cf. *Zellerbach v. Allenberg*, 99 Cal. 57; 33 Pac. 786 (where the creditor was defendant in equity and obtained the relief without filing a cross-bill.)

⁷ *Harrold v. Plenty* (1901), 2 Ch. 314.

wards paid off, he cannot hold it as security for another debt.¹ But the creditor's lien covers his claim for reimbursement for any assessments on the shares which he is legally compellable to pay or which he is requested by the debtor to pay.²

The debtor is of course entitled to redeem; and this right he may assign, and after notice of the assignment the creditor is bound to treat such assignee as the owner of the shares subject to the lien and to accord him all the rights of such owner.³ At least, under some circumstances, the debtor may file a bill to redeem.⁴

§ 1002. **Redelivery of Certificate to Debtor.** — The lien will be deemed to have been waived if the creditor redeliver the certificate to the debtor, who will thereupon be able to transfer an unincumbered title to the shares.⁵

(4) § 1003. **Transfer to Creditor on Company's Books coupled with Qualification that the Shares are held as Security merely.** — There is little authority as to the rights of the parties where shares are transferred by a debtor on the books of the company to his creditor with an entry indicating that they are held as collateral security merely.⁶ The creditor is entitled to collect dividends payable in respect of the shares.⁷ The rights of the

¹ *Niles v. Edwards*, 90 Cal. 10; 27 Pac. 159; *Harris v. Franklin Bank*, 77 Md. 423; 26 Atl. 523.

Cf. *Riley v. Hampshire, etc. Bank*, 164 Mass. 482; 41 N. E. 679; *Dayton Nat. Bank v. Merchants' Nat. Bank*, 37 Oh. St. 208; *Leahy v. Lobdell*, 80 Fed. 665; 26 C. C. A. 75; *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120; 22 N. E. 524 (as to the effect of renewal of notes, etc.); *Boyd v. Conshohocken Worsted Mills*, 149 Pa. St. 363; 24 Atl. 287.

² *Iowa Nat. Bank v. Cooper* (Iowa), 107 N. W. 625.

³ *Le Marchant v. Moore*, 150 N. Y. 209; 44 N. E. 770.

Cf. *First Nat. Bank v. Root*, 107 Ind. 224; 8 N. E. 105.

⁴ *Treadwell v. Clark* (N. Y.), 82 N. E. 505.

⁵ *Hershey v. Welch*, 104 N. W. 821; 96 Minn. 145.

⁶ Cf. *Spreckels v. Nevada Bank*, 113 Cal. 272; 45 Pac. 329; 33 L. R. A. 459; 54 Am. St. Rep. 348; *Noyes Bros.*, 136 Fed. 977 (as to what is sufficient indication on the books that the shares are held in pledge); *Pauly v. State Loan, etc. Co.*, 165 U. S. 606; 17 Sup. Ct. 465 (creditor not liable as shareholder where shares registered in his name as pledgee); *Frater v. Old Nat. Bank*, 101 Fed. 391; 42 C. C. A. 133 (where shares held by bank as collateral security were registered in name of "C., cashier O. N. Bank," held, bank not liable).

⁷ *Hunt v. Laconia, etc. Ry. Co.*, 68 N. H. 561; 39 Atl. 437; *Page Belting Co. v. Prince* (N. J.), 67 Atl. 401.

parties *inter sese* would seem to be the same as in the case where the transfer or mortgage is not recorded in the company's books.

(5) § 1004. **Transfer on the Company's Books absolute in Form.**—In this case, as in the preceding, the rights of the parties *inter sese* do not in general differ greatly from the case where the certificate and transfer in blank are delivered to the creditor but where the debtor remains registered as the absolute owner.¹ Indeed, we have seen above that according to the better view the creditor to whom a blank transfer has been delivered has the right to fill up the blank with his own name and have himself registered as shareholder. Accordingly, the creditor has an implied power of sale after the lapse of a reasonable time after default.² The creditor who is registered as though absolute owner is entitled as between himself and his debtor as well as between himself and the company to any dividends declared on the hypothecated shares,³ until the debt be paid; but upon payment, the debtor as between himself and the creditor becomes entitled to the dividends.⁴ Inasmuch as the legal title is in the creditor, the debtor may file a bill in equity to redeem upon payment of the debt.⁵ With respect to third persons, in-

¹ Cf. *Nabring v. Bank of Mobile*, 58 Ala. 204; *Markham v. Jandon*, 41 N. Y. 235; *Greene v. Dispeau*, 14 R. I. 575. As to parol evidence to qualify the apparently absolute transfer, see § 1005.

² *Deverges v. Sandeman, Clark & Co.* (1902), 1 Ch. 579.

³ *Boyd v. Conshohocken Mills*, 149 Pa. St. 363; 24 Atl. 287.

Cf. *Guarantee Co. v. East Rome Town Co.*, 96 Ga. 511; 23 S. E. 503; 51 Am. St. Rep. 150; *Roland v. Lancaster, etc. Bank*, 135 Pa. St. 598; 19 Atl. 951; *Nelson v. Owen*, 113 Ala. 372; 21 So. 75; *Colburn v. Riley*, 11 Colo. App. 184; 52 Pac. 684; *Gemmell v. Davis*, 75 Md. 546; 23 Atl. 1032; 32 Am. St. Rep. 412.

⁴ *Cross v. Eureka Lake, etc. Co.*, 73 Cal. 302; 14 Pac. 885; 2 Am. St. Rep. 808.

Cf. *Maxwell v. Nat. Bank of Greenville*, 70 S. Car. 532; 50 S. E.

195 (transferee from pledgee not liable to account for dividends collected by pledgee).

⁵ *Hasbrouck v. Vandervoort*, 4 Sandf. (N. Y.) 74; *Newton v. Fay*, 10 Allen (Mass.) 505; *Bryson v. Rayner*, 25 Md. 424; 90 Am. Dec. 69.

Cf. *Gilmer v. Morris*, 80 Ala. 78; 60 Am. Rep. 85 (where the debtor was barred by laches); *Greene v. Dispeau*, 14 R. I. 575 (same point as preceding case); *Waterman v. Brown*, 31 Pa. St. 161 (same point as preceding); *Roberts v. Sykes*, 30 Barb. (N. Y.) 173 (claim barred by limitations); *Lauman's Appeal*, 68 Pa. St. 88 (where the transfer was held to be a conditional sale and not collateral security); *Crimp v. McCormick Co.*, 71 Fed. 356; 18 C. C. A. 70 (same point as last case); *Hower*

v. Weiss, etc. Co., 55 Fed. 356; 5 C. C. A. 129; *Gilmer v. Morris*, 43

cluding the corporation, the creditor is clothed with an apparent ownership of the most complete character.¹ If by reason of such apparent ownership, the creditor is compelled to pay to the company calls or assessments on the shares, the debtor cannot redeem without refunding to the creditor the sums so expended.² But, on the other hand, the creditor owes no duty to the debtor to pay such calls or assessments; and therefore the debtor cannot complain if the creditor suffers the shares to be forfeited for non-payment.³

§ 1005. *Parol Evidence of Terms of Agreement between Debtor and Creditor.* — It has been said that where an absolute transfer of shares is made on the books of a corporation, parol evidence is not admissible to show that the transfer was intended as collateral security merely;⁴ but this dictum, if supportable at all, — an hypothesis which to say the least is doubtful,⁵ — must be confined to cases where the rights of third persons are involved, for between the parties the transfer takes effect, at least in equity, according to their actual intent.⁶ Parol evidence, however, is not admissible to vary the terms of an express written contract of hypothecation.⁷

§ 1006–§ 1008. *Co-ownership of Shares.*

§ 1006. *Rights and Liabilities of Co-owners.* — Where shares are held by tenants in common or joint tenants, — e. g., by several co-trustees, — each co-owner is liable as though he were the sole owner of all the shares in severalty, and not merely for his proportionate part of the total liability attaching to the shares.⁸ *A fortiori*, where shares are held by joint tenants, upon

Fed. 456 (reconsidered and reaffirmed, 46 Fed. 333, 335–336).

¹ *Thompson v. Toland*, 48 Cal. 99; *National Bank v. Case*, 99 U. S. 628.

² *McCalla v. Clark*, 55 Ga. 53.

³ *Marine Bank v. Biays*, 4 H. & J. (Md.) 338.

⁴ *Bend v. Susquehanna Bridge, etc. Co.*, 6 H. & J. (Md.) 128, 133–134; 14 Am. Dec. 261. This case would seem to be on this point overruled by later Maryland cases, in which, however, the property in

question was not shares or stock. *Baughner v. Merryman*, 32 Md. 185.

⁵ *McMahon v. Macy*, 51 N. Y. 155; *May v. Genesee County Sav. Bank*, 120 Mich. 330; 79 N. W. 630.

⁶ *Brick v. Brick*, 98 U. S. 514; *Travers v. Leopold*, 124 Ill. 431; 16 N. E. 902; *Newton v. Fay*, 10 Allen (Mass.) 505; *Ginz v. Stumph*, 73 Ind. 209.

⁷ *Fay v. Gray*, 124 Mass. 500.

Cf. *Fairbank v. Merchants' Nat. Bank*, 132 Ill. 120; 22 N. E. 524.

⁸ *Cunninghame v. City of Glasgow*

the death of one of them the whole liability devolves upon the survivor.¹ One of two or more co-tenants of shares has no power to transfer the shares so held, or any of them, without the concurrence of all his co-tenants;² but where shares are owned by a partnership any partner may execute a valid transfer just as he may assign other firm property, without the assent of his co-partners.³ Where three out of four co-owners of shares are permitted by the company to transfer on the books their proportion of the shares, the result is that the remaining joint owner, especially if he be a minor, becomes entitled in severalty as against the company to the remaining shares, so that the company cannot claim a lien upon them for debts of the other co-holders.⁴ Where two co-trustees in breach of trust invest trust funds in partly paid shares, the executor of one of them is not liable to the company for a call made after the testator's death, but is nevertheless liable to the surviving trustee for contribution.⁵

§ 1007. **Transfer to Tenants in Common, whether Company compellable to register.** — In England, it has been held that a corporation is not compellable to register shares or stock in the names of two or more persons as tenants in common.⁶ The process of reasoning seems to have been that the corporation ought not to be obliged to inquire into the proportionate share of each co-owner, as would be necessary upon the death of one tenant in common; but this argument does not furnish a very satisfactory basis for the conclusion, to the mind of an American lawyer. The English court further held that a corporation and an individual cannot hold either land or personal property as joint tenants; since the *jus accrescendi* would not be mutual, the corporation being inevitably the survivor.⁷ Hence, the

Bank, 4 A. C. 607; *Gillespie v. City of Glasgow Bank*, 4 A. C. 632.

¹ *Hill's Case*, 20 Eq. 597; *National Trustees, etc. Co.*, 21 Vict. L. R. 75 (holding that estate of deceased joint tenant is not liable for calls made during his lifetime).

² *Barton v. London & N. W. Ry. Co.*, 24 Q. B. D. 77.

³ *Sargent v. Franklin Ins. Co.*, 8 Pick. (Mass.) 90, 97; 19 Am. Dec. 306.

⁴ *Presbyterian Congregation v. Carlisle Bank*, 5 Pa. St. 345.

⁵ *Jackson v. Dickinson* (1903), 1 Ch. 947.

⁶ *Law Guarantee Soc. v. Bank of England*, 24 Q. B. D. 406. As to a provision in an incorporation paper that no two or more persons should be registered as joint owners of any share or shares, see *Consterdine v. Consterdine*, 31 Beav. 330 (stated supra, § 985 note).

⁷ Cf. supra, § 76.

court held, the Bank of England cannot be compelled to register a transfer of consols to a corporation and a natural person;¹ for they would necessarily hold as tenants in common and, as above stated, a company is not in England compellable to register shares or stock in the names of two persons as tenants in common. The entire decision, premises and conclusion, is unsuited to American business methods, and would therefore hardly be followed anywhere in the United States.

§ 1008. **Joint Ownership not Evidence of Trusteeship.** — Although joint ownership of shares is most common in the case of co-trustees, yet the mere fact that shares stand in the joint names of two or more individuals is no evidence of a trust sufficient to put a purchaser upon inquiry.²

§ 1009–§ 1011. *Executory Limitations of Shares.*

§ 1009: **In general — Duty of Company to protect Remainderman.** — Shares in corporations, being permanent and valuable property, are often settled upon one person for life with limitations in remainder after his death. Such limitations may in America be either legal or equitable.³ In either case, the company, if it have notice of the limitations, is bound to protect the interest of the remainderman.

If the company registers an absolute transfer by or to the owner of the particular estate, thus imperilling the rights of the remainderman, the latter may compel the company to respond in damages.⁴ The statute of limitations does not begin to run against any such right of action until the determination of the particular estate.⁵ Moreover, the measure of damages is the value of the shares at the time of the termination of the particular estate and not at the time of the transfer or, so to speak, of the conversion.⁶ This right of action is vested in the re-

¹ *Law Guarantee Soc. v. Bank of England*, 24 Q. B. D. 406. *man*, 5 Gill (Md.) 336; *Stewart v. Firemen's Ins. Co.*, 53 Md. 565.

² *Dodds v. Hills*, 2 Hem. & Miller 424. ⁵ *Wooten v. Wilmington, etc. R. Co.*, 38 S. E. Rep. 298, 302; 128 N. Car. 119; 56 L. R. A. 615. Cf. *Farmers', etc. Bank v. Wayman*, 5 Gill (Md.) 336, 358.

³ See Gray on Perpetuities, 2d ed., § 88–§98.

⁴ *Cox v. First Nat. Bank*, 119 N. Car. 302; 26 S. E. 22; *Wooten v. Railroad*, 128 N. Car. 119; 56 L. R. A. 615; 38 S. E. 298. But see contra: *Yeager v. Bank of Kentucky* (Ky.), 106 S. W. 806.

Cf. *Farmers', etc. Bank v. Way-* ⁶ *Caulkins v. Gas-Light Co.*, 85

mainderman and not in the administrator *de bonis non* of the testator by whose will the estate for life was created.¹ But if the testator directs that the shares shall be transferred into the tenant for life's own name, he in effect directs that, so far at least as the company is concerned, the tenant for life shall have full power of disposition, so that the company is not liable for registering a transfer to the tenant for life absolutely and by him to a purchaser, although the tenant for life is acting fraudulently and converts the proceeds of sale to his own use.²

If the shares are registered in the name of the tenant for life, they may upon his death be transferred into the name of the remainderman without the payment of duty.³

§ 1010. **Liability for Calls as between Tenant for Life and Remainderman.** — As between the tenant for life and remainderman, any liability for calls made during the running of the life estate should be borne by the corpus of the estate and not by the tenant for life personally or out of his income.⁴ Indeed, so closely is this rule adhered to that even a testator's express directions that any calls which may at any time "become due in respect of any shares for the time being constituting part of my residuary personal estate" shall be paid out of income, will be confined to calls upon shares owned by the testator at the time of his death, and will not be deemed to apply to calls upon additional shares in the same companies allotted to the executors in respect of their ownership of shares held by the testator.⁵ If the tenant for life advances money to pay the calls, he is entitled to a lien on the shares for the amount advanced.⁶ As between the legatees of the shares (including both the tenant for life and the remaindermen), and the residuary estate of the testator, the liability for calls is governed by the rules above stated as to specific and residuary legatees.⁷ If the shares settled for life are during the running of the life estate part of the residue but are specifically bequeathed in remainder, calls

Tenn. 683; 4 S. W. 287; 4 Am. St. Rep. 786.

¹ *Yager's Admr. v. Bank of Kentucky* (Ky.), 100 S. W. 848.

² *Hughes v. Drovers', etc. Bank*, 86 Md. 418; 38 Atl. 936.

³ *Hennell v. Strong*, 25 L. J. Ch. 407.

⁴ *Clive v. Clive*, Kay 600.

⁵ *Bevan v. Waterhouse*, 3 Ch. D. 752.

⁶ *Rowley v. Unwin*, 2 K. & J. 138;

Todd v. Moorehouse, 19 Eq. 69.

⁷ *Supra*, § 976.

made during the life estate are not to be borne by the shares themselves but may be paid out of other parts of the residuary estate which do not yield so good an income and which are not specifically bequeathed in remainder.¹

§ 1011. **Mutual Rights of Tenant for Life and Remainderman with respect to Dividends, Bonuses, etc.** — The difficult questions which arise as to the respective rights of tenant for life and remainderman as to dividends, especially extraordinary dividends, and as to proceeds of sale augmented by prospect of a dividend, are elsewhere discussed.² So, too, the question whether upon an increase of capital the right of the old shareholders to subscribe to the new shares before any allotment to the public is to be treated as income or capital, as between a tenant for life and a remainderman, is the subject of consideration in another chapter.³ It would seem that the tenant for life may exercise the right to vote.⁴

¹ *Re Box*, 1 Hem. & Mill. 552.

² See *infra*, § 1377-§ 1396.

³ See *supra*, § 607.

⁴ Cf. *State ex rel. Tozer v. Probate*

Court (Minn.), 113 N. W. 888 (where the deed creating the estate for life expressly so provided).

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